

General Fund Principal Statements





Limitations to the Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the entity, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the entity in accordance with GAAP for Federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Principal Statements

The FY 2006 Department of the Navy General Fund Principal Statements and related notes are presented in the format prescribed by the Department of Defense Financial Management Regulation 7000.14, Volume 6B. The statements and related notes summarize financial information for individual funds and accounts within the General Fund for the fiscal year ending September 30, 2006, and are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2005.

The following statements comprise the Department of the Navy General Fund Principal Statements:

- Consolidated Balance Sheet
- Consolidated Statement of Net Cost
- Consolidated Statement of Changes in Net Position
- Combined Statement Budgetary Resources
- Combined Statement of Financing

The Principal Statements and related notes have been prepared to report financial position pursuant to the requirements of the Chief Financial Officers Act of 1990, as amended by the Government Management Reform Act of 1994. The accompanying notes should be considered an integral part of the Principal Statements.

Department of Defense

Department of the Navy General Fund

CONSOLIDATED BALANCE SHEET

As of September 30, 2006 and 2005

(\$ in thousands)

	2006 Consolidated	2005 Restated
ASSETS (Note 2)		
Intragovernmental:		
Fund Balance with Treasury (Note 3)		
Entity	\$ 95,941,461	\$ 85,734,659
Non-entity Seized Iraqi Cash	0	0
Non-entity - Other	474,507	344,546
Investments (Note 4)	9,751	9,519
Accounts Receivable (Note 5)	159,270	281,305
Other Assets (Note 6)	468,259	672,257
Total Intragovernmental Assets	\$ 97,053,248	\$ 87,042,286
Cash and Other Monetary Assets (Note 7)	176,306	305,440
Accounts Receivable (Note 5)	3,231,414	3,267,657
Loans Receivable (Note 8)	0	0
Inventory and Related Property (Note 9)	58,794,634	55,584,837
General Property, Plant and Equipment (Note 10)	186,979,669	181,547,138
Investments (Note 4)	0	0
Other Assets (Note 6)	8,608,875	6,988,791
TOTAL ASSETS	\$ 354,844,146	\$ 334,736,149
LIABILITIES (Note 11)		
Intragovernmental:		
Accounts Payable (Note 12)	\$ 1,035,043	\$ 1,208,703
Debt (Note 13)	0	0
Other Liabilities (Note 15 & Note 16)	4,460,153	3,826,048
Total Intragovernmental Liabilities	\$ 5,495,196	\$ 5,034,751
Accounts Payable (Note 12)	1,265,536	1,180,034
Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (Note 17)	1,513,644	1,532,819
Environmental and Disposal Liabilities (Note 14)	17,268,813	17,050,451
Loan Guarantee Liability (Note 8)	0	0
Other Liabilities (Note 15 and Note 16)	5,749,764	4,459,836
TOTAL LIABILITIES	\$ 31,292,953	\$ 29,257,891
NET POSITION		
Unexpended Appropriations - Earmarked Funds (Note 23)	\$ 1,550	\$ 0
Unexpended Appropriations - Other Funds	99,697,752	89,739,876
Cumulative Results of Operations - Earmarked Funds	18,843	0
Cumulative Results of Operations - Other Funds	223,833,048	215,738,382
TOTAL NET POSITION	\$ 323,551,193	\$ 305,478,258
TOTAL LIABILITIES AND NET POSITION	\$ 354,844,146	\$ 334,736,149

The accompanying notes are an integral part of these statements.

Department of Defense

Department of the Navy General Fund

CONSOLIDATED STATEMENT OF NET COST

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	<u>2006 Consolidated</u>	<u>2005 Consolidated</u>
Program Costs		
Gross Costs	\$ 129,530,253	\$ 123,610,807
(Less: Earned Revenue)	<u>(3,912,287)</u>	<u>(8,181,148)</u>
Net Costs	\$ 125,617,966	\$ 115,429,659
Costs Not Assigned to Programs	0	0
(Less: Earned Revenue Not Attributable to Programs)	<u>0</u>	<u>0</u>
Net Cost of Operations	<u><u>\$ 125,617,966</u></u>	<u><u>\$ 115,429,659</u></u>

The accompanying notes are an integral part of these statements.

Department of Defense

Department of the Navy General Fund

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	Earmarked Funds	Other Funds
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	\$ 23,558	\$ 192,496,533
Prior period adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	0	23,218,292
Beginning balances, as adjusted	\$ 23,558	\$ 215,714,825
Budgetary Financing Sources:		
Appropriations received	\$ 0	\$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	861	132,896,065
Nonexchange revenue	564	0
Donations and forfeitures of cash and cash equivalents	18,858	0
Transfers in/out without reimbursement (+/-)	0	50,000
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	187,068
Imputed financing from costs absorbed by others	0	578,058
Other (+/-)	0	0
Total Financing Sources	\$ 20,283	\$ 133,711,191
Net Cost of Operations (+/-)	24,998	125,592,968
Net Change	(4,715)	8,118,223
Ending Balances	\$ 18,843	\$ 223,833,048
UNEXPENDED APPROPRIATIONS		
Beginning Balances	\$ 2,311	\$ 89,737,565
Prior period adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	0	0
Beginning balances, as adjusted	\$ 2,311	\$ 89,737,565
Budgetary Financing Sources:		
Appropriations received	\$ 100	\$ 145,492,145
Appropriations transferred-in/out (+/-)	0	617,410
Other adjustments (rescissions, etc) (+/-)	0	(3,253,303)
Appropriations used	(861)	(132,896,065)
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Total Financing Sources	\$ (761)	\$ 9,960,187
Net Cost of Operations (+/-)	0	0
Net Change	(761)	9,960,187
Ending Balances	\$ 1,550	\$ 99,697,752

The accompanying notes are an integral part of the statements.

Department of Defense

Department of the Navy General Fund

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	<u>2006 Consolidated</u>	<u>2005 Restated</u>
CUMULATIVE RESULTS OF OPERATIONS		
Beginning Balances	\$ 192,520,091	\$ 188,170,325
Prior period adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	23,218,292	23,218,291
Beginning balances, as adjusted	\$ 215,738,383	\$ 211,388,616
Budgetary Financing Sources:		
Appropriations received	\$ 0	\$ 0
Appropriations transferred in/out (+/-)	0	0
Other adjustments (rescissions, etc) (+/-)	0	0
Appropriations used	132,896,926	119,015,668
Nonexchange revenue	564	205
Donations and forfeitures of cash and cash equivalents	18,858	29,518
Transfers in/out without reimbursement (+/-)	50,000	150,000
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	187,068	(1,652)
Imputed financing from costs absorbed by others	578,058	585,686
Other (+/-)	0	0
Total Financing Sources	\$ 133,731,474	\$ 119,779,425
Net Cost of Operations (+/-)	125,617,966	115,429,659
Net Change	8,113,508	4,349,766
Ending Balances	\$ 223,851,891	\$ 215,738,382
UNEXPENDED APPROPRIATIONS		
Beginning Balances	\$ 89,739,876	\$ 79,161,774
Prior period adjustments (+/-)		
Changes in accounting principles (+/-)	0	0
Correction of errors (+/-)	0	0
Beginning balances, as adjusted	\$ 89,739,876	\$ 79,161,774
Budgetary Financing Sources:		
Appropriations received	\$ 145,492,245	\$ 130,972,538
Appropriations transferred-in/out (+/-)	617,410	164,674
Other adjustments (rescissions, etc) (+/-)	(3,253,303)	(1,543,442)
Appropriations used	(132,896,926)	(119,015,668)
Nonexchange revenue	0	0
Donations and forfeitures of cash and cash equivalents	0	0
Transfers in/out without reimbursement (+/-)	0	0
Other budgetary financing sources (+/-)	0	0
Other Financing Sources:		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	0	0
Imputed financing from costs absorbed by others	0	0
Other (+/-)	0	0
Total Financing Sources	\$ 9,959,426	\$ 10,578,102
Net Cost of Operations (+/-)	0	0
Net Change	9,959,426	10,578,102
Ending Balances	\$ 99,699,302	\$ 89,739,876

The accompanying notes are an integral part of the statements.

Department of Defense

Department of the Navy General Fund

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	<u>2006 Combined</u>	<u>2005 Combined</u>
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources:		
Unobligated balance, brought forward, October 1	\$ 17,128,479	\$ 18,027,995
Recoveries of prior year unpaid obligations	5,261,990	11,446,435
Budget Authority:		
Appropriations received	145,511,602	131,002,361
Borrowing authority	0	0
Contract authority	0	0
Spending authority from offsetting collections:		
Earned		
Collected	7,767,620	8,830,639
Change in receivables from Federal sources	(948,730)	696,667
Change in unfilled customer orders	0	0
Advances received	54,329	147,708
Without advance from Federal sources	519,073	(636,393)
Anticipated for rest of year, without advances	0	0
Previously unavailable	0	0
Expenditure transfers from trust funds	0	0
Subtotal	\$ 152,903,894	\$ 140,040,982
Nonexpenditure transfers, net, anticipated and actual	667,410	314,674
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(3,253,303)	(1,543,442)
Total Budgetary Resources	\$ 172,708,470	\$ 168,286,644
Status of Budgetary Resources:		
Obligations incurred:		
Direct	\$ 146,006,781	\$ 137,694,376
Reimbursable	5,865,715	13,463,789
Subtotal	\$ 151,872,496	\$ 151,158,165
Unobligated balance:		
Apportioned	\$ 19,197,595	\$ 15,607,505
Exempt from apportionment	0	0
Subtotal	19,197,595	15,607,505
Unobligated balances not available	1,638,379	1,520,974
Total status of budgetary resources	\$ 172,708,470	\$ 168,286,644

The accompanying notes are an integral part of these statements.

Department of Defense

Department of the Navy General Fund

COMBINED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	<u>2006 Combined</u>	<u>2005 Combined</u>
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Change in Obligated Balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	\$ 72,093,186	\$ 67,196,765
Less: Uncollected customer payments from	<u>(3,400,814)</u>	<u>(3,340,541)</u>
Federal sources, brought forward, October 1		
Total unpaid obligated balance	<u>68,692,372</u>	<u>63,856,224</u>
Obligations incurred, net (+/-)	\$ 151,872,496	\$ 151,158,165
Less: Gross outlays	<u>(140,615,673)</u>	<u>(134,815,308)</u>
Obligated balance transferred, net		
Actual transfers, unpaid obligations (+/-)	0	0
Actual transfers, uncollected customer	<u>0</u>	<u>0</u>
payments from Federal sources (+/-)		
Total Unpaid obligated balance transferred, net	<u>0</u>	<u>0</u>
Less: Recoveries of prior year unpaid obligations, actual	<u>(5,261,990)</u>	<u>(11,446,435)</u>
Change in uncollected customer	429,657	(60,273)
payments from Federal sources (+/-)		
Obligated balance, net, end of period		
Unpaid obligations	78,088,020	72,093,186
Less: Uncollected customer payments from	<u>(2,971,157)</u>	<u>(3,400,814)</u>
Federal sources		
Total Unpaid obligated balance, net, end of period	<u><u>75,116,863</u></u>	<u><u>68,692,372</u></u>
Net Outlays:		
Net Outlays:		
Gross Outlays	140,615,673	134,815,308
Less: Offsetting collections	<u>(7,821,950)</u>	<u>(8,978,348)</u>
Less: Distributed Offsetting receipts	<u>(149,284)</u>	<u>(115,805)</u>
Net Outlays	<u><u>\$ 132,644,439</u></u>	<u><u>\$ 125,721,155</u></u>

The accompanying notes are an integral part of the statements.

Department of Defense

Department of the Navy General Fund

CONSOLIDATED STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	<u>2006 Consolidated</u>	<u>2005 Consolidated</u>
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	\$ 151,872,496	\$ 151,158,165
Less: Spending authority from offsetting collections and recoveries (-)	(12,654,282)	(20,485,056)
Obligations net of offsetting collections and recoveries	139,218,214	130,673,109
Less: Offsetting receipts (-)	(149,284)	(115,805)
Net obligations	139,068,930	130,557,304
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	187,068	(1,652)
Imputed financing from costs absorbed by others	578,058	585,686
Other (+/-)	0	0
Net other resources used to finance activities	765,126	584,034
Total resources used to finance activities	<u>\$ 139,834,056</u>	<u>\$ 131,141,338</u>
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services and benefits		
benefits ordered but not yet provided		
Undelivered orders (-)	\$ (6,657,708)	\$ (13,332,332)
Unfilled Customer Orders	573,402	(488,685)
Resources that fund expenses recognized in prior periods	(101,501)	(269,715)
Budgetary offsetting collections and receipts that do not affect Net		
Cost of Operations	149,284	0
Resources that finance the acquisition of assets	(28,364,037)	(14,697,475)
Other resources or adjustments to net obligated resources that do not		
affect Net Cost of Operations		
Less: Trust or Special Fund Receipts related to exchange in the		
entity's budget (-)	0	0
Other (+/-)	(187,068)	1,652
Total resources used to finance items not part of the Net		
Cost of Operations	<u>\$ (34,587,628)</u>	<u>\$ (28,786,555)</u>
Total resources used to finance the Net Cost of Operations	<u>\$ 105,246,428</u>	<u>\$ 102,354,783</u>

The accompanying notes are an integral part of these statements.

Department of Defense

Department of the Navy General Fund

CONSOLIDATED STATEMENT OF FINANCING

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	<u>2006 Consolidated</u>	<u>2005 Consolidated</u>
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
Increase in annual leave liability	\$ 43,363	\$ 170,047
Increase in environmental and disposal liability	230,378	1,028,763
Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	<u>208,377</u>	<u>69,091</u>
Total components of Net Cost of Operations that will require or generate resources in future periods	\$ 482,118	\$ 1,267,901
Components not Requiring or Generating Resources:		
Depreciation and amortization	\$ 21,243,453	\$ 15,844,303
Revaluation of assets or liabilities (+/-)	1,865,416	(1,785,299)
Other (+/-)		
Trust Fund Exchange Revenue	0	(10)
Cost of Goods Sold	0	0
Operating Materials & Supplies Used	(3,209,774)	(2,244,170)
Other	<u>(9,675)</u>	<u>(7,849)</u>
Total components of Net Cost of Operations that will not require or generate resources	\$ 19,889,420	\$ 11,806,975
Total components of Net Cost of Operations that will not require or generate resources in the current period	\$ 20,371,538	\$ 13,074,876
Net Cost of Operations	<u><u>\$ 125,617,966</u></u>	<u><u>\$ 115,429,659</u></u>

The accompanying notes are an integral part of these statements.

General Fund
to the Principal Statements



Note 1. Significant Accounting Policies

1.A. Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Department of the Navy (DON) General Fund (GF), as required by the “Chief Financial Officers (CFO) Act of 1990,” expanded by the “Government Management Reform Act (GMRA) of 1994,” and other appropriate legislation. The financial statements have been prepared from the books and records of DON in accordance with the “Department of Defense Financial Management Regulation” Office of Management and Budget (OMB) Circular A-136, Financial Reporting Requirements, and to the extent possible, Generally Accepted Accounting Principles (GAAP). The accompanying financial statements account for all resources for which DON GF is responsible. Information relative to classified assets, programs, and operations is aggregated and reported in such a manner that it is not discernable.

The DON is unable to fully implement all elements of GAAP and OMB Circular A-136 due to limitations of its financial management processes and systems, and nonfinancial systems and processes that feed into the financial statements. The DON derives its reported values and information for major asset and liability categories, largely from nonfinancial systems, such as inventory systems and logistic systems. These systems were designed to support reporting requirements for maintaining accountability over assets and reporting the status of Federal appropriations rather than preparing financial statements in accordance with GAAP. The DON continues to implement process and system improvements addressing these limitations. The DON currently has four auditor identified financial statement material weaknesses: (1) accuracy and complete reporting of accounts payable, (2) identifying and reporting environmental disposal liabilities, (3) military equipment reporting, and (4) valuation of inventory and operating materials and supplies.

Fiscal year (FY) 2006 represents the eleventh year that DON has prepared audited financial statements as required by CFO Act and GMRA.

1.B. Mission of the Reporting Entity

The Department of the Navy (DON) was created on April 30, 1798 by an act of Congress (I Stat. 533; 5 U.S.C. 411-12). The overall mission of DON is to maintain, train, and equip combat-ready Navy and Marine Corps forces capable of winning wars, deterring aggression and maintaining freedom of the seas.

1.C. Appropriations and Funds

The DON receives its appropriations and funds as general, working capital (revolving funds), trust, special, and deposit funds. The DON uses these appropriations and funds to execute its mission and report on resource usage.

General funds are used for financial transactions funded by congressional appropriations, including personnel, operations and maintenance, research and development, procurement, and military construction accounts.

Revolving funds receive their initial funding through an appropriation or a transfer of resources from existing appropriations or funds and use those capital resources to finance the initial startup. Financial resources to replenish the initial working capital and to permit continuing operations are generated by the acceptance of customer orders on a reimbursable basis. The National Defense Sealift Fund is DON General Fund’s only revolving fund.

Trust funds contain receipts and expenditures of funds held in trust by the government for use in carrying out specific purposes or programs in accordance with the terms of the donor, trust agreement, or statute.

Special fund accounts are used to record government receipts reserved for a specific purpose.

Deposit funds are used to record amounts held temporarily until paid to the appropriate government or public entity. The DON is acting as an agent or a custodian for funds awaiting distribution, for example payroll taxes.

Certain special and trust funds may be designated as earmarked funds. Earmarked funds are financed by specifically identified revenues, required by statute to be used for designated activities, benefits or purposes, and remain available over time. Earmarked funds also have a requirement to account for and report on the receipt, use and retention of revenues and other financing sources that distinguish it from general revenues.

The asset accounts used to prepare the statements are categorized as either entity or nonentity. Entity accounts consist of resources that the agency has the authority to use, or where management is legally obligated to use funds to meet entity obligations. Nonentity accounts are assets that are held by an entity but are not available for use in the operations of the entity.

OMB Circular A-136 provides guidance for reporting Parent-Child (Allocation) Transfer accounts. As the recipient of allocations from parent accounts, DON has determined that the allocation transfers are not material to its financial statements.

Entity Accounts:

General Accounts

17X0380	Coastal Defense Augmentation, Navy
17 0703	Family Housing, Navy and Marine Corps
17 0730	Family Housing Construction, Navy and Marine Corps
17 0735	Family Housing Operation and Maintenance, Navy and Marine Corps
17X0810	Environmental Restoration, Navy
17 1000	Medicare Eligible Retiree Health Care Fund, Military Personnel Navy
17 1001	Medicare Eligible Retiree Health Care Fund, Military Personnel Marine Corps
17 1002	Medicare Eligible Retiree Health Care Fund, Reserve Personnel Navy
17 1003	Medicare Eligible Retiree Health Care Fund, Reserve Personnel Marine Corps
17 1105	Military Personnel, Marine Corps
17 1106	Operation and Maintenance, Marine Corps
17 1107	Operation and Maintenance, Marine Corps Reserve
17 1108	Reserve Personnel, Marine Corps
17 1109	Procurement, Marine Corps
17 1205	Military Construction, Navy and Marine Corps
17 1235	Military Construction, Navy Reserve
17 1236	Payments to Kaho'Olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy
17 1319	Research, Development, Test and Evaluation, Navy
17 1405	Reserve Personnel, Navy
17 1453	Military Personnel, Navy
17 1506	Aircraft Procurement, Navy
17 1507	Weapons Procurement, Navy
17 1508	Procurement of Ammunition, Navy and Marine Corps
17 1611	Shipbuilding and Conversion, Navy
17 1804	Operation and Maintenance, Navy
17 1806	Operation and Maintenance, Navy Reserve
17 1810	Other Procurement, Navy

Revolving Funds

17 4557 National Defense Sealift Fund, Navy

Earmarked Trust Funds

17X8716 Department of the Navy General Gift Fund
 17X8723 Ships Stores Profits, Navy
 17X8733 United States Naval Academy General Gift Fund

Earmarked Special Funds

17X5095 Wildlife Conservation, Military Reservations, Navy
 17X5185 Kaho’Olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy
 17X5429 Rossmoor Liquidating Trust Settlement Account
 17X5562 Ford Island Improvement Account

General Fund Receipt, Deposit, Suspense, and Clearing Accounts

17 1XXX Receipt Accounts
 17 3XXX Receipt Accounts
 17X6XXX Deposit Funds

Parent-Child (Allocation) Transfer Accounts

17 47X0535 Embassy Security, Defense Relocation Program, State Department
 17 11 1081 International Military Education and Training Funds, appropriated to the President
 17 11X1081 International Military Education and Training Funds, appropriated to the President
 17 11 1082 Foreign Military Financing Program Funds appropriated to the President
 17 12X1105B State and Private Forestry, Forest Service
 17 69X8083 Federal-Aid Highways (Liquidation of Contract Authorization), Federal Highway Administration

1.D. Basis of Accounting

For FY 2006, DON’s General Fund financial management systems are unable to meet all of the requirements for full accrual accounting. Many of DON’s financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of GAAP for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of DON’s legacy systems were designed to record information on a budgetary basis.

The Department has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with GAAP. One such action is the revision of its accounting systems to record transactions based on the United States Standard General Ledger (USSGL). Until all of DON’s financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, DON’s financial data will be largely based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

In addition, DON identifies program costs based upon the major appropriation groups provided by the Congress. Current processes and systems do not capture and report accumulated costs for major programs based upon the performance measures as required by the Government Performance and Results Act (GPRA). The DoD is in the process of reviewing available data and attempting to develop a cost reporting methodology that balances the need for cost information required by the Statement of Federal Financial Accounting Standard (SFFAS) No. 4, “Managerial Cost Accounting Concepts and

Standards for the Federal Government,” with the need to keep the financial statements from being overly voluminous.

1.E. Revenues and Other Financing Sources

The DON receives congressional appropriations as financing sources for general funds on either an annual or multi-year basis. When authorized by legislation, these appropriations are supplemented by revenues generated by sales of goods or services. The DON recognizes revenue as a result of costs incurred or services provided to other Federal agencies and the public. Full cost pricing is DON’s standard policy for services provided as required by OMB Circular A-25. The DON recognizes revenue when earned within the constraints of current system capabilities. In other instances, revenue is recognized when bills are issued.

The DON does not include nonmonetary support provided by U.S. allies for common defense and mutual security in amounts reported in the Statement of Net Cost and the Statement of Financing. The U.S. has cost sharing agreements with other countries. Examples include counties where there is a mutual or reciprocal defense agreement, where U.S. troops are stationed, or where the U.S. fleet is in a port.

1.F. Recognition of Expenses

For financial reporting purposes, DoD policy requires the recognition of operating expenses in the period incurred. However, because DON’s financial and nonfinancial feeder systems were not designed to collect and record financial information on the full accrual accounting basis, accrual adjustments are made for major items such as payroll expenses, accounts payable, environmental liabilities, and unbilled revenue. The DON’s expenditures for capital and other long-term assets are recognized as operating expenses based on depreciation. In the case of Operating Materials and Supplies (OM&S), operating expenses are generally recognized when the items are purchased. Efforts are underway to migrate towards the consumption method for recognizing OM&S expenses.

1.G. Accounting for Intragovernmental Activities

Preparation of reliable financial statements requires the elimination of transactions occurring among entities within DON, within DoD, or between two or more federal agencies. However, DON cannot consistently and accurately identify all of its intragovernmental transactions by customer because DON’s accounting systems do not track all buyer and seller data needed to match related transactions. For the DON GF, the Defense Finance and Accounting Service (DFAS) is responsible for eliminating transactions and balances between components or activities of DON. Seller entities within DoD provided summary seller-side balances for revenue, accounts receivable, and unearned revenue to the buyer-side internal DoD accounting offices. In most cases, the buyer-side records are adjusted to agree with DoD seller-side balances. Intra-DoD intragovernmental balances are eliminated when DoD financial statements are prepared. The DON properly eliminates the revenue resulting from intra-DoD sales of capitalized assets. The DoD is developing long-term system improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished effectively with existing or foreseeable resources.

The Department of the Treasury Financial Management Service (FMS) is responsible for eliminating transactions between DoD and other federal agencies. The Treasury Financial Manual, Part 2 – Chapter 4700, “Agency Reporting Requirements for the Financial Report of the United States Government” and the Treasury’s “Federal Intragovernmental Transaction Accounting Policy Guide” provide guidance for reporting and reconciling intragovernmental balances. While DON is unable to fully reconcile all intragovernmental transactions with all federal partners, DON is able to reconcile balances pertaining to investments in federal securities, borrowings from the U.S. Treasury and the Federal Financing Bank, Federal Employees’ Compensation Act transactions with the Department of Labor (DOL), and benefit

program transactions with the Office of Personnel Management (OPM). The DoD's proportionate share of public debt and related expenses of the federal government are not included. The federal government does not apportion debt and its related costs to federal agencies. The DoD's financial statements, therefore, do not report any portion of the public debt or interest thereon, nor do the statements report the source of public financing whether from issuance of debt or tax revenues.

Financing for the construction of DoD facilities is obtained through appropriations. To the extent this financing ultimately may have been obtained through the issuance of public debt, interest costs have not been capitalized since the Department of the Treasury does not allocate such interest costs to the benefiting agencies.

1.H. Transactions with Foreign Governments and International Organizations

Each year, DON sells defense articles and services to foreign governments and international organizations under the provisions of the "Arms Export Control Act of 1976." Under the provisions of the Act, DoD has authority to sell defense articles and services to foreign countries and international organizations generally at no profit or loss to the U.S. Government. Payment is required in advance.

1.I. Funds with the U.S. Treasury

The DON's monetary financial resources are maintained in U.S. Treasury accounts. The disbursing offices of the Defense Finance and Accounting Service (DFAS), the Military Services, the U. S. Army Corps of Engineers (USACE), and the Department of State's financial service centers process the majority of the DON's cash collections, disbursements, and adjustments worldwide. Each disbursing station prepares monthly reports that provide information to the U.S. Treasury on check issues, electronic fund transfers, interagency transfers and deposits.

In addition, DFAS sites and USACE Finance Center submit reports to the Department of the Treasury, by appropriation, on interagency transfers, collections received, and disbursements issued. The Department of the Treasury records this information to the applicable Fund Balance with Treasury (FBWT) account. Differences between DON's recorded balance in FBWT accounts and Treasury's FBWT accounts sometimes result and are subsequently reconciled.

1.J. Foreign Currency

Cash is the total of cash resources under the control of DON, which includes coin, paper currency, negotiable instruments, and amounts held for deposit in banks and other financial institutions. Foreign currency consists of the total U.S. dollar equivalent of both purchased and nonpurchased foreign currencies held in foreign currency fund accounts. Cash and foreign currency is classified as nonentity and, therefore, is restricted. Amounts reported consist primarily of cash and foreign currency held by Disbursing Officers to carry out their paying, collecting, and foreign currency accommodation exchange missions.

The DON conducts a significant portion of its operations overseas. The Congress established a special account to handle the gains and losses from foreign currency transactions for five general fund appropriations (Operations and Maintenance, Military Personnel, Military Construction, Family Housing Operations and Maintenance, and Family Housing Construction.) The gains and losses are computed as the variance between the exchange rate current at the date of payment and a budget rate established at the beginning of each fiscal year. Foreign currency fluctuations related to other appropriations require adjustments to the original obligation amount at the time of payment. The DON does not separately identify foreign currency fluctuations.

1.K. Accounts Receivable

As presented in the Balance Sheet, accounts receivable includes accounts, claims, and refunds receivable from other federal entities or from the public. Allowances for doubtful accounts due from the public are based upon analysis of collection experience by fund type. The DON does not recognize an allowance for estimated doubtful amounts from other federal agencies. Claims against other federal agencies are to be resolved between the agencies (per Code of Federal Regulations 4 CFR 101).

1.L. Direct Loans and Loan Guarantees

Not applicable.

1.M. Inventories and Related Property

Most of DON's Inventory and Related Property are currently reported at an approximation of historical cost using latest acquisition cost (LAC) adjusted for holding gains and losses. The DON General Fund's Inventory and Related Property consists of Operating Materials and Supplies (OM&S). The DON uses LAC and other methods as its inventory systems were designed for material management rather than accounting purposes. Although these systems provide visibility and accountability over inventory items, they do not maintain historical cost data necessary to comply with the SFFAS No. 3, "Accounting for Inventory and Related Property." Additionally, these systems cannot produce financial transactions using the USSGL, as required by the Federal Financial Management Improvement Act of 1996 (P.L. 104-208). By utilizing new systems development processes, DON is beginning to transition the inventory to the moving average cost method. At this point, DON is unable to determine the value of OM&S that is being reported using moving average cost methodology. However, since the on-hand balances which transitioned were not, for the most part, baselined to auditable historical cost, the reported values remain noncompliant with SFFAS No. 3 and GAAP.

The DON manages only military or government specific material under normal conditions. Items commonly used in and available from the commercial sector are not managed in DON material management activities. Operational cycles are irregular, and the military risks associated with stock-out positions have no commercial parallel. The DON holds material based on military need and support for contingencies. Therefore, DON does not attempt to account separately for "inventory held for sale" and "inventory held in reserve for future use" based on SFFAS No. 3 definitions.

Related property includes operating materials and supplies (OM&S) and stockpile materials. The OM&S, including munitions not held for sale, are valued at standard purchase price. The DoD uses both the consumption method and the purchase method of accounting for OM&S. Items that are centrally managed and stored, such as ammunition and engines, are generally recorded using the consumption method and are reported on the Balance Sheet as OM&S. When current systems cannot fully support the consumption method, DON uses the purchase method. Under this method, materials and supplies are expensed when purchased. During FY 2006, DON expensed significant amounts using the purchase method because the systems could not support the consumption method or management deemed that the item was in the hands of the end user. DON does not hold stockpile materials.

The DON determined that the recurring high dollar value of OM&S in need of repair is material to the financial statements and requires a separate reporting category. Many high dollar items, such as aircraft engines, are categorized as OM&S rather than military equipment.

The DON recognizes condemned material as "Excess, Obsolete, and Unserviceable." The cost of disposal is greater than the potential scrap value; therefore the net value of condemned material is zero. Potentially redistributed material, presented in previous years as "Excess, Obsolete, and Unserviceable," is included in the "Held for Use" or "Held for Repair" categories according to its condition.

1.N. Investments in U.S. Treasury Securities

For the Trust Funds, DON reports investments in U.S. Treasury securities at cost, net of amortized premiums or discounts. Premiums or discounts amortize into interest income over the term of the investment using the effective interest rate method or another method obtaining similar results. The DON's intent is to hold investments to maturity, unless they are needed to finance claims or otherwise sustain operations. Consequently, no provision is made for unrealized gains or losses on these securities.

The DON invests in nonmarketable securities. The two types of nonmarketable securities are par value and market-based intragovernmental securities. The Bureau of Public Debt issues nonmarketable par value intragovernmental securities. Nonmarketable, market-based intragovernmental securities mimic marketable securities, but are not traded publicly.

1.O. General Property, Plant and Equipment

The DoD is moving away from a standard capitalization threshold for all categories (e.g. real property, military equipment, etc.) of General Property, Plant and Equipment (PP&E) to one that is specific for each individual category.

The capitalization threshold was revised from \$100,000 to \$20,000 for real property. The DON has not implemented the \$20,000 real property capitalization threshold yet pending an evaluation of real property systems, processes, and procedures that will have to be revised in order to implement the lowered threshold. The current \$100,000 capitalization threshold remains unchanged for the remaining General PP&E categories.

General PP&E assets are capitalized at historical acquisition cost plus capitalized improvements when an asset has a useful life of two or more years and the acquisition cost equals or exceeds DoD capitalization threshold. DoD also requires capitalization of improvement costs over DoD capitalization threshold for General PP&E. The DON depreciates all General PP&E, other than land, on a straight-line basis. Land is not depreciated.

Prior to fiscal year 1996, General PP&E was capitalized if it had an acquisition cost of \$15,000, \$25,000, and \$50,000 for fiscal years 1993, 1994, and 1995, respectively, and an estimated useful life of two or more years. General PP&E previously capitalized at amounts below \$100,000 were written off DON General Fund financial statements in fiscal year 1998.

When it is in the best interest of the government, DON provides government property to contractors when deemed necessary to complete contract work. The DON either owns or leases such property, or it is purchased directly by the contractor for the government based on contract terms. When the value of contractor-procured General PP&E exceeds the DoD capitalization threshold, it must be reported on DON's Balance Sheet.

The DoD is developing new policies and a contractor reporting process that will provide appropriate General PP&E information for future financial statement reporting purposes. Accordingly, DON reports only government property in the possession of contractors that is maintained in DON's property systems. The DoD has issued new property accountability and reporting requirements that requires DON to maintain, in its property systems, information on all property furnished to contractors. This action and other DoD proposed actions are structured to capture and report the information necessary for compliance with Federal accounting standards.

The SFFAS No. 23, "Eliminating the Category National Defense Property, Plant, and Equipment," establishes generally accepted accounting principles for valuing and reporting military equipment (e.g., ships, aircraft, combat vehicles, weapons) in federal financial statements. The Standard provides for the use of estimated historical cost for valuing military equipment if obtaining actual historical cost

information is not practical. The DON used Bureau of Economic Analysis (BEA) to calculate the value of the military equipment for reporting periods from October 1, 2002 through March 31, 2006.

Effective with 3rd Quarter, FY 2006, the DON replaced the BEA estimation methodology with an estimation methodology for military equipment based on DON internal records. The DON initially identified the universe of military equipment by accumulating information relating to program funding and associated military equipment, equipment useful life, program acquisitions and disposals to create a baseline. The military equipment baseline is updated using expenditure information, and information related to acquisition and disposals.

1.P. Advances and Prepayments

The DON records payments in advance of the receipt of goods and services as advances or prepayments and reports them as assets on the Balance Sheet. The DON recognizes advances and prepayments as expenses when it receives the related goods and services.

1.Q. Leases

Lease payments for the rental of equipment and operating facilities are classified as either capital or operating leases. When a lease is essentially equivalent to an installment purchase of property (a capital lease) DON records the applicable asset and liability if the value equals or exceeds the current capitalization threshold. The DON records the amounts as the lesser of the present value of the rental and other lease payments during the lease term (excluding portions representing executory costs paid to the lessor) or the asset's fair market value. The discount rate for the present value calculation is either the lessor's implicit interest rate or the government's incremental borrowing rate at the inception of the lease. The DON as the lessee receives the use and possession of the leased property, for example real estate or equipment, from a lessor in exchange for a payment of funds. An operating lease does not substantially transfer all of the benefits or risks of ownership. Payments for operating leases are charged to expense over the lease term as it becomes payable.

Leases for office space entered into by DON are the largest component of operating leases. These costs were gathered from existing leases, General Service Administration (GSA) bills, and Inter-service Support Agreements. Future year projections use the Consumer Price Index (CPI), rather than the DoD inflation factor. The CPI impacts increases to the leases, especially those at commercial lease sites. Equipment leases have a variety of lease terms, which are not expected to be renewed upon expiration. Other operating leases are generally one-year leases. The DON expects to continue to reduce the level of owned assets while increasing the number of leased assets. The DON will strive to displace commercial leases with more economical GSA leases.

1.R. Other Assets

The DON conducts business with commercial contractors under two primary types of contracts: fixed price and cost reimbursable. To alleviate the potential financial burden on the contractor that long-term contracts can cause, DON provides financing payments. One type of financing payment that the DON makes for real property is based upon a percentage of completion. In accordance with the SFFAS No. 1, "Accounting for Selected Assets and Liabilities," such payments are treated as Construction-in-Progress and are reported on the General PP&E line on the Balance Sheet and in the related note.

Other assets include those assets, such as military and civil service employee pay advances, travel advances, and contract financing payments that are not reported elsewhere on the DON's Balance Sheet.

Contract financing payments are defined in the Federal Acquisition Regulations (FAR), Part 32, as authorized disbursements of monies to a contractor prior to acceptance of supplies or services by the Government. These payments are designed to alleviate the potential financial burden on contractors

performing on certain long-term contracts and facilitate competition for defense contracts. Contract financing payments clauses are incorporated in the contract terms and conditions and may include advance payments, performance-based payments, commercial advance and interim payments, progress payments based on cost, and interim payments under certain cost-reimbursement contracts. Contract financing payments do not include invoice payments, payments for partial deliveries, lease and rental payments, or progress payments based on a percentage or stage of completion, which the Defense Federal Acquisitions Regulations Supplement (DFARS) authorizes only for construction of real property, shipbuilding, and ship conversion, alteration, or repair. Progress payments for real property are reported as Construction in Progress in Note 10.

1.S. Contingencies and Other Liabilities

The SFFAS No. 5, "Accounting for Liabilities of the Federal Government," as amended by SFFAS No. 12, "Recognition of Contingent Liabilities Arising from Litigation," defines a contingency as an existing condition, situation, or set of circumstances that involves an uncertainty as to possible gain or loss. The uncertainty will be resolved when one or more future events occur or fail to occur. The DON recognizes contingent liabilities when past events or exchange transactions occur, a future loss is probable, and the loss amount can be reasonably estimated.

Financial statement reporting is limited to disclosure when conditions for liability recognition do not exist but there is at least a reasonable possibility of incurring a loss or additional losses. Examples of loss contingencies include the collectibility of receivables, pending or threatened litigation, and possible claims and assessments. The DON's loss contingencies arise as a result of pending or threatened litigation or claims and assessments occur due to events such as aircraft, ship and vehicle accidents, medical malpractice, property or environmental damages, and contract disputes.

Other liabilities arise as a result of anticipated disposal costs for DON's assets. This type of liability has two components: nonenvironmental and environmental. Consistent with SFFAS No. 6, "Accounting for Property, Plant, and Equipment," recognition of an anticipated environmental disposal liability begins when the asset is placed into service. Nonenvironmental disposal liabilities are recognized for assets when management decides to dispose of the asset based upon DoD's policy, which is consistent with SFFAS No. 5 "Accounting for Liabilities of Federal Government." The DON recognizes nonenvironmental disposal liabilities for military equipment nuclear-powered assets when placed in service. Such amounts are developed in conjunction with, and not easily identifiable separately from, environmental disposal costs.

1.T. Accrued Leave

The DON reports as liabilities military leave and civilian earned leave except sick leave that has been accrued and not used as of the Balance Sheet date. Sick leave is expensed as taken. The liability reported at the end of the accounting period reflects the current pay rates.

1.U. Net Position

Net Position consists of unexpended appropriations and cumulative results of operations.

Unexpended Appropriations represent the amounts of authority that are unobligated and have not been rescinded or withdrawn. Unexpended appropriations also represent amounts obligated for which legal liabilities for payments have not been incurred.

Cumulative Results of Operations represent the net difference, since inception of an activity, between expenses and losses and financing sources (including appropriations, revenue, and gains). Beginning with FY 1998, the cumulative results also include donations and transfers in and out of assets without reimbursement.

1.V. Treaties for Use of Foreign Bases

The DON has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. The DON purchases capital assets overseas with appropriated funds; however, the host country retains title to land and improvements. Generally, treaty terms allow DON continued use of these properties until the treaties expire. In the event treaties or other agreements are terminated, whereby use of the foreign bases is prohibited, losses are recorded for the value of any nonretrievable capital assets. This takes place after negotiations between U.S. and the host country have determined the amount to be paid the U.S. for such capital investments.

1.W. Comparative Data

The Financial Statements and accompanying Notes to the Financial Statements report the financial position and results of operations for FY 2006. Financial statement fluctuations greater than two percent of total assets on the Balance Sheet or greater than ten percent from the prior period presented are explained within the Notes to the Financial Statements.

1.X. Unexpended Obligations

The DON obligates funds to provide goods and services for outstanding orders not yet delivered. The financial statements do not reflect this liability for payment for goods and services not yet delivered.

1.Y. Undistributed Disbursements and Collections

Undistributed disbursements and collections represent the difference between disbursements and collections matched at the transaction level to a specific obligation, payable, or receivable in the activity field records as opposed to those reported by the U.S. Treasury. These amounts should agree with the undistributed amounts reported on the departmental accounting reports. In-transit payments are those payments that have been made by other agencies or entities that have not been recorded in the DON's accounting records. These payments are applied to the DON's outstanding accounts payable balance. In-transit collections are those collections from other agencies or entities that have not been recorded in the accounting records. These collections are also applied to the DON's accounts receivable balance.

The DoD policy is to allocate supported undistributed disbursements and collections between federal and nonfederal categories based on the percentage of federal and nonfederal accounts payable and accounts receivable. Unsupported undistributed disbursements are recorded in accounts payable. Unsupported undistributed collections are recorded in other liabilities. The DON follows this procedure.

1.Z. Data Collection Approach

The DON financial statements include information from both financial systems and nonfinancial feeder systems. The Defense Finance Accounting Service, Cleveland (DFAS-CL) and Kansas City (DFAS-KC) collect the financial system information and incorporate it into the financial statements. The DON collects financial information from nonfinancial feeder systems through a data call process and submits it to DFAS-CL and DFAS-KC for incorporation into the financial statements. DFAS also collects information from multiple sources, such as intragovernmental data from DON's trading partners, which is incorporated into the financial statements. For FY 2006, DON is utilizing a web-based data collection instrument (DCI) that captures certain required financial information from feeder systems for the General Fund (GF) statements. This is the seventh year DON has used the DCI to collect information from feeder systems. The DON DCI identifies the information requirements to the source provider, provides an audit trail, and integrates into the financial statement preparation process. The DON is transitioning the data collection process to the Defense Departmental Reporting System (DDRS) Data Collection Module (DCM). When the transition to DCM is complete, the stand-alone DCI legacy application will be terminated.

Note 2. Nonentity Assets

As of September 30	2006	2005 Restated
<i>(Amounts in thousands)</i>		
1. Intragovernmental Assets		
A. Fund Balance with Treasury	\$ 474,507	\$ 344,546
B. Accounts Receivable	0	0
C. Total Intragovernmental Assets	\$ 474,507	\$ 344,546
2. Nonfederal Assets		
A. Cash and Other Monetary Assets	\$ 176,306	\$ 305,440
B. Accounts Receivable	3,142,047	2,538,987
C. Other Assets	0	0
D. Total Nonfederal Assets	\$ 3,318,353	\$ 2,844,427
3. Total Nonentity Assets	\$ 3,792,860	\$ 3,188,973
4. Total Entity Assets	\$ 351,051,286	\$ 331,547,176
5. Total Assets	\$ 354,844,146	\$ 334,736,149

Fluctuations and Abnormalities

The DON reported an increase in Total Nonentity Assets (Line 3) of \$603.9 million, 19%, in FY 2006 which is primarily attributed to accounts receivable as described below.

Nonfederal Assets.

Nonentity Nonfederal Accounts Receivable (Line 2.B): The DON reported an increase of \$603.0 million, 24%. A receivable of \$345.6 million that was classified in FY 2005 as "currently not collectible" was not reported as a nonentity receivable. However, DON began reporting this as an active nonentity receivable in the 1st Quarter, FY 2006, due to a change in the litigation status. Furthermore, in 4th Quarter, FY 2005, \$210.8 million of out-of-service debt that should have been classified as nonentity was erroneously classified as an entity receivable. This classification error was corrected in 1st Quarter, FY 2006.

Information Related to Nonentity Assets

Definitions

Entity accounts.

Assets that DON has the authority to use, or those that management is legally obligated to use to meet entity obligations.

Nonentity accounts.

Assets held by an entity, but are not available for use in the operations of the entity.

Other Disclosures

Nonentity Assets.

For FY 2006, DON holds \$3.8 billion nonentity assets. These assets are not available for use by DON in its day-to-day operations but DON maintains stewardship accountability and reporting responsibility. There are three categories of significant nonentity assets held by DON: (1) the Intragovernmental Fund

Balance with Treasury, (2) the Nonfederal Cash and Other Monetary Assets, and (3) the Nonfederal Accounts Receivable.

Nonentity Nonfederal Accounts Receivable (Public).

For FY 2006, the DON holds \$3.1 billion of nonentity nonfederal accounts receivable. The primary component is a principal amount of \$1.3 billion, representing advance payments made to contractors and \$1.3 billion in associated accrued interest which remains in litigation. These receivable balances are being reported in nonentity accounts receivable since the original appropriation year has been cancelled, and any funds collected as a result of this litigation would go to the Department of the Treasury and not be available for DON's use in normal operations. See Note 5 for additional information.

Intragovernmental Fund Balance with Treasury.

This asset category, in the amount of \$474.5 million represents amounts in DON's deposit and receipt fund accounts that are not available for DON's use in normal operations. The increase of \$130.0 million, 38% from FY 2005 is primarily due to increased participation by deployed Sailors and Marines, in the savings plans that were established by Congress for their benefit while serving overseas.

Cash and Other Monetary Assets.

This asset category, in the amount of \$176.3 million, represents disbursing officers' cash and undeposited collections as reported on the Statement of Accountability. These assets are held by DON disbursing officers as agents of the Treasury and are not available for DON's use in normal operations. See Note 7 for additional information.

Note 3. Fund Balance with Treasury

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Fund Balances		
A. Appropriated Funds	\$ 93,541,772	\$ 83,215,340
B. Revolving Funds	2,387,470	2,501,771
C. Trust Funds	9,917	14,564
D. Special Funds	2,302	2,984
E. Other Fund Types	474,507	344,546
F. Total Fund Balances	<u>\$ 96,415,968</u>	<u>\$ 86,079,205</u>
2. Fund Balances Per Treasury Versus Agency		
A. Fund Balance per Treasury	\$ 97,613,850	\$ 86,922,093
B. Fund Balance per DON	<u>96,415,968</u>	<u>86,079,205</u>
3. Reconciling Amount	<u>\$ 1,197,882</u>	<u>\$ 842,888</u>

Explanation of Reconciliation Amount:

Parent/ Child Allocation Accounts	\$34,380
Invalid Program Years	120,524
Canceling Years	1,042,978
Total Reconciling Amount	<u>\$1,197,882</u>

Fund Balance Per Treasury Calculation:

Undisbursed Appropriation Account Trial Balance (FMS 6654)	\$97,521,347
Receipt Account Trial Balance (FMS 6655)	111,860
Less: 6655 Trust Funds Balances included in 6654	(19,153)
Less: 6655 Special Funds Balances included in 6654	(204)
Fund Balance Per Treasury	<u><u>\$97,613,850</u></u>

The Financial Management Service (FMS) 6653, which is the Undisbursed Appropriation Account Ledger, includes the current month's transactions and cumulative balances for any appropriation that had financial activity during the month. FMS 6653 is systematically interfaced with the Standard Accounting and Reporting System (STARS) for posting expenditure transactions. FMS 6654, which is the Undisbursed Appropriation Account Trial Balance, includes any activity and the cumulative balances for all appropriations regardless of whether they had activity for the month. Since the FMS 6654 is all-inclusive, this report is used to calculate Fund Balance with Treasury (FBWT). FMS 6655 is the Receipt Account Trial Balance.

The total reconciling amount of \$1.2 billion is primarily due to \$1.0 billion in FBWT for appropriations that were canceled on September 30, 2006 and thus not reported on DON's balance sheet. However, the FBWT for these canceled appropriations was reported by Treasury at September 30, 2006. Invalid program year numbers, primarily an extended availability Shipbuilding and Conversion, Navy appropriation, represent duplicative reporting at Treasury accounting for \$120.5 million of the reconciling difference. The DON is working with Treasury to resolve the issue. Finally, \$34.4 million of Parent/child Allocation accounts, primarily Treasury symbol 1081, International Military Education and Training with a balance of \$34.0 million, comprised the remaining reconciling item. The DON, as the "child", is the recipient of allocation transfers from other Federal agencies and has determined that the allocations are not material to the DON financial statements. The providing agency, as the "parent", is responsible for reporting the FBWT for these allocations.

Fluctuations and Abnormalities

The overall increase in FBWT of \$10.3 billion, 12% is directly related to the \$14.5 billion, 11% increase in Appropriations Received that have not been fully executed. This increase in FBWT is primarily attributable to an increase in multi-year appropriations of \$8.1 billion (\$6.2 billion in Procurement and \$1.5 billion in RDT&E). The increase in the procurement appropriations is to address the requirement for the acquisition, modernization, and recapitalization of the Fleet. The increase in RDT&E is to meet the requirements for process innovation, transitioning science and technology to the acquisition community and the warfighter, and general research and development use.

Status of Fund Balance with Treasury

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Unobligated Balance		
A. Available	\$ 19,197,595	\$ 15,607,505
B. Unavailable	1,638,379	1,520,974
2. Obligated Balance not yet Disbursed	\$ 78,088,020	\$ 72,093,187
3. Nonbudgetary FBWT	\$ 472,698	\$ 267,741
4. NonFBWT Budgetary Accounts	\$ (2,980,724)	\$ (3,410,202)
5. Total	\$ 96,415,968	\$ 86,079,205

Other Information Related to Status of Fund Balance with Treasury

Fluctuations and Abnormalities

Total Status of FBWT increased \$10.3 billion, 12% in FY 2006. The increase is a result of the Unobligated, Available Line 1.A, which represents budget authority that is currently available for new obligations, increasing \$3.6 billion, 23% and Obligated Balance not yet Disbursed, representing expected future expenditures, increasing \$5.9 billion, 8% in FY 2006. This increase is primarily attributable to an increase in multi-year appropriations of \$8.1 billion (\$6.2 billion in Procurement and \$1.5 billion in RDT&E) and the residual balances associated with the multi-year appropriation that have not been fully executed.

Definitions

The Status of Fund Balance with Treasury consists of unobligated and obligated balances. These balances reflect the budgetary authority remaining for disbursements against current or future obligations. In addition, the status includes various accounts that affect either budgetary reporting or Fund Balance with Treasury, but not both.

Unobligated balance represents the cumulative amount of budgetary authority that has not been set aside to cover outstanding obligations. Unobligated balance is classified as available or unavailable and is associated with appropriations expiring at fiscal year end that remain available only for obligation adjustments until the account is closed.

Obligated Balance not yet Disbursed represents funds that have been obligated for goods that have not been received or services that have not been performed.

Non-Budgetary FBWT includes entity and nonentity Fund Balance with Treasury accounts which do not have budgetary authority, such as unavailable receipt accounts or clearing accounts.

Non-FBWT Budgetary Accounts include budgetary accounts that do not affect FBWT, such as contract authority, borrowing authority and investment accounts. This category reduces the Status of Fund Balance with Treasury.

Other Disclosures

Unobligated, Unavailable balances are restricted to future use and are not apportioned for current use.

Although funds have been appropriated, single year appropriations such as Operation and Maintenance and Military Pay accounts, are not available for obligation because the period for obligation established by law has lapsed. Multi-year accounts and "X" or no year accounts are restricted based on their appropriation type. Trust funds and Earmarked funds are restricted to their intended use.

Disclosures Related to Suspense/Budget Clearing Accounts

As of September 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 - 2006
<i>(Amounts in thousands)</i>				
Account				
F3845 – Personal Property Proceeds	\$ 0	\$ 0	\$ 0	\$ 0
F3875 – Disbursing Officer Suspense	(253,211)	(27,725)	72	27,797
F3880 – Lost or Cancelled Treasury Checks	2,453	3,946	3,378	(568)
F3882 – Uniformed Services Thrift Savings Plan Suspense	(37,698)	32,891	46,500	13,609
F3885 – Interfund/IPAC Suspense	(133,156)	(53,025)	(5,260)	47,765
F3886 – Thrift Savings Plan Suspense	9	429	(28)	(457)
Total	\$ (421,603)	\$ (43,484)	\$ 44,662	\$ 88,146

Fluctuations and Abnormalities

The total amount in Suspense/Budget Clearing Accounts increased \$88.1 million, 203%, from the prior period credit balance, in FY 2006. Account F3885 – Interfund/IPAC Suspense increased \$47.8 million, 90% from the prior period credit balance, in FY 2006 as a result of a reduction of items in suspense. Account F3875 – Disbursing Officer Suspense increased \$27.8 million, 100% from the prior period credit balance as a result of efforts to clear aged suspended transactions throughout FY 2006. These efforts are part of the DON Financial Improvement Plan and include an analysis of the types of inflows into the suspense accounts. Additionally, DON is establishing policies and procedures to ensure accurate and consistent use of these accounts.

Disclosures Related to Suspense/Budget Clearing Accounts

The F3875 suspense clearing account reported a positive balance of \$72.0 thousand that represents the Disbursing Officer's (DO) suspense. Account F3885, which includes the Interfund/IPAC suspense, reported a negative balance of \$5.3 million. The F3882 suspense clearing account reported a positive balance of \$46.5 million that represents the Uniformed Services Thrift Savings Plan established in FY 2002. The amounts in this account represent a timing difference between the posting of the Thrift Savings Plan deductions by the National Finance Center and the posting of these amounts in the military accounting systems in the following month.

Account F3886, representing the civilian Thrift Savings Plan suspense, has a credit balance of \$28 thousand. The F3880 suspense account reported a positive balance of \$3.4 million. This amount represents the balance of Treasury checks that (1) have either been lost by the payee and need to be reissued, (2) have never been cashed by the payee, or (3) have been cancelled by the Treasury and need to be transferred to the original appropriation.

Disclosures Related to Problem Disbursements and In-Transit Disbursements

As of September 30	2004	2005	2006	(Decrease)/ Increase from FY 2005 to 2006
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(Amounts in thousands)

1. Total Problem Disbursements, Absolute Value

A. Unmatched Disbursements (UMDs)	\$ 183,570	\$ 1,313,996	\$ 984,547	\$ (329,449)
B. Negative Unliquidated Obligations (NULO)	32,110	17,086	15,396	(1,690)

2. Total In-transit

Disbursements, Net	\$ (23,714)	\$ 857,860	\$ 384,940	\$ (472,920)
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Fluctuations and Abnormalities

Since FY 2005 Unmatched Disbursements (UMDs) have decreased by \$329.4 million or 25%. Negative Unliquidated Obligations (NULOs) have decreased \$1.7 million, 10% since FY 2005. The DON and DFAS have partnered to reduce UMD and NULO balances and the significant reductions are reflective of those efforts. In 2nd Quarter, FY 2005, DFAS-Cleveland expanded the scope of the definition of an UMD. Formerly, transactions that had not yet reached an accounting station were defined as undistributed. Now these transactions are being defined as an UMD. This change in practice was the primary driver behind the increase from FY 2004 to FY 2005.

In-Transit Disbursements, Net decreased \$472.9 million, 55%, since FY 2005. This decrease reflects a concerted effort by DON and DFAS to identify systemic errors and implement corrective actions through synchronization of edit tables to validate data between systems.

In March 2006, DON submitted a plan of action and milestones to the Under Secretary of Defense (Comptroller) (OUSD(C))- that describes how the DON will work in conjunction with DFAS to resolve aged problem disbursements.

Definitions

An Unmatched Disbursement (UMD) occurs when a payment is not matched to a corresponding obligation in the accounting system.

Absolute Value is the sum of the positive values of debit and credit transactions without regard to the sign.

A Negative Unliquidated Obligation (NULO) occurs when a payment is made against a valid obligation, but the payment is greater than the amount of the obligation recorded in the official accounting system. These payments have been made using available funds and are based on valid receiving reports for goods and services delivered under valid contracts.

In-Transit Disbursements, Net represent the net value of disbursements and collections made by a DoD disbursing activity on behalf of an accountable activity which have not been posted in an accounting system. Of the \$384.9 million reported for DON General Fund, only \$39.8 million, 10%, is over 30 days old.

Other Disclosures

The elimination of both Problem Disbursements and In-transits is one of the highest financial management priorities of OUSD(C). Problem Disbursements and In-transits represent a significant financial management concern since: (1) accuracy of accounting reports is affected; (2) availability of funds is more difficult to determine, and (3) the required research and resolution process becomes much more labor intensive as the age of the problem disbursements increase. As a result, DON has efforts underway to improve the systems and to resolve previous problem disbursements and process in-transit disbursements.

The DON includes Foreign Military Sales in the amount of \$105.1 thousand in Problem Disbursement amounts and DON is in balance with the Problem Disbursement metric.

Note 4. Investments and Related Interest

As of September 30	2006				
	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure

(Amounts in thousands)

1. Intragovernmental Securities

A. Nonmarketable, Market-Based	\$ 9,633		\$ (23)	\$ 9,610	\$ 9,610
B. Accrued Interest	141			141	141
C. Total Intragovernmental Securities	\$ 9,774		\$ (23)	\$ 9,751	\$ 9,751

2. Other Investments

A. Total Investments	\$ 0		\$ 0	\$ 0	N/A
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As of September 30	2005				
	Cost	Amortization Method	Amortized (Premium) / Discount	Investments, Net	Market Value Disclosure

(Amounts in thousands)

1. Intragovernmental Securities

A. Nonmarketable, Market-Based	\$ 9,421		\$ (2)	\$ 9,419	\$ 9,419
B. Accrued Interest	100			100	100
C. Total Intragovernmental Securities	\$ 9,521		\$ (2)	\$ 9,519	\$ 9,519

2. Other Investments

A. Total Investments	\$ 0		\$ 0	\$ 0	N/A
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Fluctuations and Abnormalities

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for this reporting period.

Other Disclosures

The two DON Trust Funds holding interest-bearing securities are the Naval Academy General Gift Fund and the Navy General Gift Fund, which have a total Investment net value of \$9.8 million (including \$141.6 thousand of accrued interest). These investments are Nonmarketable Market-Based U.S. Treasury securities reported at cost, net of amortized premiums and discounts. In accordance with the Statement of Federal Financial Accounting Standards No. 27, "Identifying and Reporting Earmarked Funds," DON Trust Funds are now classified and reported as earmarked funds.

Intragovernmental Investments for Earmarked Funds.

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with DON's earmarked Trust Funds. The cash receipts collected from the public for an earmarked fund are deposited in the U.S. Treasury, which uses the cash for general Government purposes. Treasury securities are issued to DON as evidence of its receipts. Treasury securities are an asset to the DON and a liability to the U.S. Treasury. Because DON and the U.S. Treasury are both parts of the United States Government, these assets and liabilities offset each other from the standpoint of the Government as a whole. For this reason, they do not represent an asset or a liability in the U.S. Governmentwide financial statements. U.S. Treasury securities provide the DON with authority to draw upon the U.S. Treasury to make future benefit payments or other expenditures. When DON requires redemption of its Treasury securities held in DON earmarked Trust Funds to make expenditures, the Government finances those expenditures out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the Government finances all other expenditures.

Note 5. Accounts Receivable

As of September 30	2006			2005
	Gross Amount Due	Allowance For Estimated Uncollectibles	Accounts Receivable, Net	Accounts Receivable, Net
<i>(Amounts in thousands)</i>				
1. Intragovernmental Receivables	\$ 159,270	N/A	\$ 159,270	\$ 281,304
2. Nonfederal Receivables (From the Public)	\$ 3,238,178	\$ (6,764)	\$ 3,231,414	\$ 3,267,657
3. Total Accounts Receivable	\$ 3,397,448	\$ (6,764)	\$ 3,390,684	\$ 3,548,961

Information Related to Accounts Receivable**Fluctuations and Abnormalities****Intragovernmental Receivables.**

The Department of the Navy (DON) General Fund (GF) acts as a seller of goods and services to other Federal agencies (DON GF's Level One trading partners) and other organizations within DoD (DON GF's Level Two trading partners). Receipt of customer orders, the resulting billing of receivables, and

the collection of those receivables from other agencies, do not consistently follow a predictable pattern. This revenue cycle is subject to the business conditions and requirements of DON's trading partners. The value of accounts receivable is also subject to the processes used for billing and collection.

The DON reported a decrease of \$122.0 million, 43%, in Intragovernmental Receivables in FY 2006. The primary factors were a decrease of \$40.5 million reported with the Department of Homeland Security (DHS) (Level One, business conducted with other Federal agencies), a decrease of \$31.5 million reported for the Navy Working Capital Fund (Level Two), and a decrease of \$21.4 million reported with Army General Fund (Level Two) as a result of Marine Corps' improved billing and collection process. The decrease with DHS represents the collection of monies for work performed for Hurricane Katrina support. The decrease with NWCF represents the completion of the conversion project, and subsequent final billing and collection for work on the USS Ohio (SSGN-726) in 2nd Quarter FY 2006.

Nonfederal Receivables.

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for this reporting period.

Allowance Method

Based upon an extensive analysis of historic public receivables, the allowance for FY 2006 was determined to be \$6.8 million.

Intragovernmental Accounts Receivable Adjustments

Allocation of Undistributed Collections.

Undistributed collections are allocated between federal and nonfederal categories based on the percentage of federal and nonfederal Accounts Receivable as submitted in the field level general ledgers. This allocation was suggested as appropriate in a DFAS Arlington memorandum of October 4, 2000, which required disclosure to the audit community of the applicable methodology used to allocate undistributed collections. For FY 2006 \$691.8 million in undistributed collections was allocated to accounts receivable.

Elimination Adjustments.

The DON's accounting systems do not consistently capture trading partner data at the transaction level in a manner that facilitates trading partner reconciliations. Therefore, DON was unable to reconcile intragovernmental accounts receivable balances with the Accounts Payable balances of its intragovernmental trading partners. Through the ongoing Business Transformation Agency effort, the Department intends to develop long-term systems improvements that will capture the data necessary to perform reconciliations.

Intrafund transactions (within DON GF) are eliminated based upon trading partner information obtained from the Naval Personnel Command, the Naval Air Systems Command Enterprise Resource Planning system, the Standard Accounting and Reporting System – Field Level (STARS-FL), and the Standard Accounting and Reporting System – Headquarters Module (STARS-HQ). The elimination data obtained from these systems included seller appropriation, grantor (buyer) appropriation, grantor subhead, grantor code, reimbursable source code, accounts receivable, revenue, unearned revenue, and amount collected.

Aged Accounts Receivable

As of September 30	2006		2005	
	Intragovernmental	Nonfederal	Intragovernmental	Nonfederal
<i>(Amounts in thousands)</i>				
CATEGORY				
Nondelinquent				
Current	\$ 381,172	\$ 535,983	\$ 687,784	\$ 774,603
Noncurrent	30,402	7,549	89,984	6,280
Delinquent				
1 to 30 days	\$ 2,188	\$ 7,022	\$ 7,227	\$ 5,270
31 to 60 days	1,101	4,737	2,299	3,406
61 to 90 days	1,150	9,687	16,596	14,467
91 to 180 days	7,409	10,598	3,630	16,348
181 days to 1 year	5,821	26,743	12,342	35,495
Greater than 1 year and less than or equal to 2 years	2,085	44,235	32,343	58,627
Greater than 2 years and less than or equal to 6 years	31,745	58,556	82,359	21,782
Greater than 6 years and less than or equal to 10 years	259	362,476	248	14,861
Greater than 10 years	0	2,605,292	0	2,526,709
Subtotal	\$ 463,332	\$ 3,672,878	\$ 934,812	\$ 3,477,848
Less Supported Undistributed Collections	(257,152)	(434,700)	(274,637)	(204,360)
Less Eliminations	(46,910)	0	(226,962)	0
Less Other	0	0	(151,909)	5,479
Total	\$ 159,270	\$ 3,238,178	\$ 281,304	\$ 3,278,967

Nondelinquent Accounts Receivables are receivables outstanding for 30 days or less or those not yet due under the contract or billing document pertaining to the receivable. Current nondelinquent accounts receivable are those that are due in the next twelve months. Noncurrent nondelinquent accounts receivable include out-of-service debt that are due beyond the next 12 months, and are valued at \$37.9 million for FY 2006. These accounts are not considered delinquent since the associated repayment schedules allow for repayment after a 30-day period. The DON is actively pursuing collection action on all accounts receivable, both public and intragovernmental, in accordance with guidance in the DoD Financial Management Regulation, Volume 4, Chapter 3 and OMB Circular A-129 "Policies for Federal Credit Programs and Non-Tax Receivables".

For public debt, these collection actions include referring delinquent vendor debt to the Debt Management Office (DMO) for servicing no later than 60 days after the payment due date, and coordinating with the DMO to further refer such debt over 180 days delinquent to the Treasury for further collection action. A current example of collection actions related to public debt is a partnership between

DON and DFAS to identify habitually delinquent public entities and develop standard processes with a goal of improving the joint business relationship. For delinquent intragovernmental debt, collection actions include detailed research of subsidiary accounting transactions with DFAS, the compilation and review of dispute packages, and consultation and negotiation with debtor agencies to resolve outstanding receivables. A current example is the extensive collaboration between DON and the Federal Emergency Management Agency to resolve delinquent receivables related to Hurricane Katrina support.

It must be recognized that, in certain instances, the status of litigation impacts the ability of the DON to actively pursue collection action on public debt.

As displayed in the previous table, the amounts reported for FY 2005 are not directly comparable to those reported for FY 2006. The methodology used to calculate delinquent receivables has changed: in FY 2005, when a receivable reached the age of 31 days, it was considered 31 days delinquent. In FY 2006 a receivable, which by terms of the repayment schedule is due in 30 days, is considered 1 day delinquent upon reaching the age of 31 days. The amounts reported in the FY 2005 "Less Other" category were required to balance the aging schedule to the financial statements. In FY 2005, there was not a requirement for an aging schedule to be published in the financial statements.

Note 6. Other Assets

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Intragovernmental Other Assets		
A. Advances and Prepayments	\$ 468,259	\$ 672,257
B. Other Assets	0	0
C. Total Intragovernmental Other Assets	\$ 468,259	\$ 672,257
2. Nonfederal Other Assets		
A. Outstanding Contract Financing Payments	\$ 8,154,326	\$ 6,859,367
B. Other Assets (With the Public)	454,549	129,424
C. Total Nonfederal Other Assets	\$ 8,608,875	\$ 6,988,791
3. Total Other Assets	\$ 9,077,134	\$ 7,661,048

Fluctuations and Abnormalities

Intragovernmental Other Assets.

The DON reported a decrease of \$204.0 million, 30%, in Advances and Prepayments, (Line 1.A), in FY 2006. The majority of the decrease was due to a \$169.6 million decrease with the Navy Working Capital Fund (NWCF) (Trading Partner Level Two). To alleviate a cash shortage in FY 2005, NWCF Shipyards were granted authority to advance bill and DON advanced NWCF \$180.9 million in FY 2005. As the NWCF cash shortage was addressed, in FY 2006 the level of advances provided by DON to NWCF has declined to \$11.3 million.

Nonfederal Other Assets.

The DON reported an increase of \$1.6 billion, 23%, in total nonfederal other assets in FY 2006. In 4th

Quarter FY 2006, in accordance with a DoD policy decision based on a DoD Inspector General audit finding, DON began recording an estimated asset (and corresponding contingent liability) for the value of in-process work that is expected to result in the delivery of finished goods. This estimated asset is \$1.2 billion. The remaining increase is attributable to the recognition of \$156.2 million in advances. The DON began recognizing these advances in 2nd Quarter, FY 2006, as a result of improved processes derived from the Financial Improvement Program.

Information Related to Other Assets

Intragovernmental Other Assets - Advances and Prepayment.

The buyer-side advances to others amounts were adjusted to agree with seller-side advances from others on the books of other DoD reporting entities (Level Two trading partners). Additionally, the buyer-side prepayment balances were adjusted to agree with seller-side deferred credits on the books of other DoD reporting entities. Material differences may exist as advances and prepayments to Other Federal Agencies (Level One trading partners) were estimated since DON accounting systems are unable to identify the agency that is being advanced money from the buyer side perspective. The estimates were based upon historical trading partner data obtained from the Intragovernmental Review and Analysis System (IRAS).

Nonfederal Other Assets - Outstanding Contract Financing Payments.

Contract terms and conditions for certain types of contract financing payments convey certain rights to the Department that protect the contract work from state or local taxation, liens or attachment by the contractor's creditors, transfer of property, or disposition in bankruptcy; however, these rights should not be misconstrued to mean that ownership of the contractor's work has transferred to the Government. The government does not have the right to take the work, except as provided in contract clauses related to termination or acceptance, and the Department is not obligated to make payment to the contractor until delivery and acceptance of a satisfactory product.

The Contract Financing Payment balance of \$8.2 billion is comprised of \$7.0 billion in contract financing payments and an additional \$1.1 billion in estimated future funded payments that will be paid to the contractor upon delivery and Government acceptance of a satisfactory product. (See additional discussion in Note 15, Other Liabilities).

Nonfederal Other Assets, Other Assets (With the Public).

The Other Assets (With the Public) includes advance pay to DON military personnel, travel advances, and miscellaneous advances to contractors.

Note 7. Cash and Other Monetary Assets

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Cash	\$ 173,389	\$ 201,999
2. Foreign Currency	2,917	103,441
3. Total Cash, Foreign Currency, & Other Monetary Assets	\$ 176,306	\$ 305,440

Fluctuations and Abnormalities

Total Cash, Foreign Currency and Other Monetary Assets (Line 3) decreased \$129.1 million, 42%. This is reflective of a decrease of \$100.5 million, 97%, in Foreign Currency. When the Marine Corps Expeditionary Forces, Camp Lejeune returned from an overseas deployment in 2nd Quarter, FY 2006, their Disbursing Officer dissolved the Limited Depositary Account that had been held in the National Bank of Kuwait. This Limited Depositary Account, in accordance with DoD FMR guidelines, is part of the Disbursing Officer's accountability for public funds.

Definitions

Cash - the total of cash resources under the control of DON, which includes coin, paper currency, purchased foreign currency, negotiable instruments, and amounts on deposit in banks and other financial institutions.

Foreign Currency - consists of the total U.S. dollar equivalent of nonpurchased foreign currencies held in foreign currency fund accounts. Nonpurchased foreign currency is limited to the Treasury Index 97X7000 fund account (formerly called FT accounts).

Restriction on Cash, Foreign Currency and Other Monetary Assets – total cash, foreign currency and other monetary assets reported are classified as nonentity, which means that the assets are not available for DON's use in normal operations. Therefore, total cash, foreign currency and other monetary assets, totaling \$176.3 million is restricted.

Other Disclosures

Cash and Foreign Currency consists primarily of cash held by Disbursing Officers to carry out their payment, collection, and foreign currency accommodation exchange mission. The primary source of the amounts reported is DoD Disbursing Officers, Statement of Accountability (Standard Form 1219).

The DON translates foreign currency to U.S. dollars utilizing the Department of the Treasury Prevailing Rate of Exchange. This rate is the most favorable rate that would legally be available to the U.S. Government's acquisition of foreign currency for its official disbursement and accommodation of exchange transactions.

Note 8. Direct Loan and/or Loan Guarantee Programs

Not Applicable.

Note 9. Inventory and Related Property

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Inventory, Net	\$ 0	\$ 0
2. Operating Materials & Supplies, Net	58,794,634	55,584,837
3. Stockpile Materials, Net	0	0
4. Total	\$ 58,794,634	\$ 55,584,837

Inventory, Net

Not Applicable.

Operating Materials and Supplies, Net

As of September 30	2006			2005	
	OM&S Gross Value	Revaluation Allowance	OM&S, Net	OM&S, Net	Valuation Method
<i>(Amounts in thousands)</i>					
1. OM&S Categories					
A. Held for Use	\$ 53,664,746	\$ 0	\$ 53,664,746	\$ 51,202,582	SP, LAC
B. Held for Repair	6,487,827	(1,357,939)	5,129,888	4,382,255	SP, LAC
C. Excess, Obsolete, and Unserviceable	582,918	(582,918)	0	0	NRV
D. Total	\$ 60,735,491	\$ (1,940,857)	\$ 58,794,634	\$ 55,584,837	

Legend for Valuation Methods:

Adjusted LAC = Latest Acquisition Cost, adjusted for holding gains and losses

NRV = Net Realizable Value

SP = Standard Price

O = Other

AC = Actual Cost

2. Restrictions on Operating Materials and Supplies (OM&S):

There are no known restrictions on the use of OM&S.

3. Other Information Related to Operating Materials and Supplies

Fluctuations and Abnormalities

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for this reporting period.

Information Related to Operating Material and Supplies, Net**General Composition of Operating Materials and Supplies (OM&S).**

OM&S includes spare and repair parts, ammunition, conventional missiles, torpedoes, aircraft configuration pods, and centrally managed aircraft engines. The general composition of OM&S is as follows:

As of September 30, 2006	
<i>(Amounts in thousands)</i>	
Ammunition and Munitions	\$ 34,813,578
Appropriation Purchase Account (APA)	
Principal End and Secondary Items	9,474,209
Sponsor Owned Material	11,882,388
Real-time Reutilization Asset	
Management (RRAM)	2,240,183
Other	384,276
Total	<u>\$ 58,794,634</u>

Balances.

The Statement of Federal Financial Accounting Standards (SFFAS) No. 3 "Accounting for Inventory and Related Property" requires disclosure of the amount of OM&S held for "Future Use." This information is not captured by current OM&S systems which were designed for material management rather than accounting purposes.

Decision Criteria For Identifying The Category To Which Operating Materials And Supplies Are Assigned.

In order to standardize the reporting categories of Held for Use; Held for Repair; and Excess, Obsolete and Unserviceable, DON implemented the Office of Under Secretary of Defense (Comptroller) (OUSD(C)) condition code crosswalk as defined in the memorandum "Accounting for Excess, Unserviceable, and Obsolete Inventory and Operating Materials and Supplies" dated August 12, 2002. In addition, the condition code crosswalk was amended to include code "V" in the Excess, Obsolete, Unserviceable category in September 2002. OM&S is reported as follows:

OM&S Category	Condition Codes
Held for Use	A, B, C, D
Held for Repair	E, F, G, J, K, L, M, N, R
Excess, Obsolete, Unserviceable	P, H, S, V

Condition Codes are used for material management purposes and are defined in the Naval Supply Systems Command (NAVSUP) Publication 409.

Valuation Method for OM&S.

On July 6, 2001, OUSD(C) issued a memorandum requiring Moving Average Cost (MAC) as the approved valuation method for Inventory Held for Sale and Operating Materials and Supplies. The memorandum directs each Military Department and Defense Agency responsible for material amounts of inventory or operating materials and supplies to implement the moving average cost valuation method as systems are renovated or replaced. The DON is participating in a DoD Business Transformation Agency effort that is currently designing and updating the Business Enterprise Architecture (BEA). The BEA includes guidance on transition plan strategy concepts, considerations, processes, and principles. MAC will be

implemented as existing OM&S systems are renovated or replaced. Until then, DON continues to value OM&S using different valuation methodologies such as standard purchase price or actual cost. These valuation methodologies vary by system.

Other Disclosures

Ammunition and Munitions.

Ammunition and Munitions are maintained and valued in the Conventional Ammunition Integrated Management System Open System Environment (CAIMS-OSE).

APA Principal End and Secondary Items.

Principal and Secondary Items include OM&S items such as shipboard hull, mechanical and electronic equipment, and uninstalled aircraft engines. They are items of such importance that central inventory control is required. They normally possess one of the following characteristics: (a) essential for combat or training; (b) high dollar value; (c) difficult to procure or produce; or (d) critical basic materials or components.

Sponsor Owned Material (SOM).

SOM is defined as programmatic material required in support of Program Manager's mission requirements for production, life cycle maintenance, and installation of systems and equipment consistent with the mission charter. The material usage may involve, but is not limited to: item fabrication, assembly, testing, manufacture, development, repair, or research and development.

Real-time Reutilization Asset Management (RRAM).

Material maintained and valued in RRAM is considered excess to the owner, but may not be excess to the Navy. Standard price is used to value all stock-numbered items. Part-numbered items are valued by best available information.

Other Operating Materials & Supplies.

Other OM&S consists primarily of Fleet Hospitals held by the Bureau of Medicine and Surgery and War Reserve material in possession of the U.S. Coast Guard.

Stockpile Materials, Net

Not Applicable.

Note 10. General PP&E, Net

As of September 30	2006					2005 Restated
	Depreciation/ Amortization Method	Service Life	Acquisition Value	(Accumulated Depreciation/ Amortization)	Net Book Value	Prior FY Net Book Value
<i>(Amounts in thousands)</i>						
1. Major Asset Classes						
A. Land	N/A	N/A	\$ 611,761	N/A	\$ 611,761	\$ 616,579
B. Buildings, Structures, and Facilities	S/L	20 Or 40	33,951,515	\$ (20,889,320)	13,062,195	14,102,743
C. Leasehold Improvements	S/L	lease term	7,643	(749)	6,894	7,129
D. Software	S/L	2-5 Or 10	3,818	(3,712)	106	205
E. General Equipment	S/L	5 or 10	2,824,043	(2,265,692)	558,351	495,262
F. Military Equipment	S/L	Various	299,030,122	(128,686,613)	170,343,509	163,498,292
G. Assets Under Capital Lease	S/L	lease term	115	(11)	104	0
H. Construction-in- Progress	N/A	N/A	2,396,749	N/A	2,396,749	2,826,928
I. Other			0	0	0	0
J. Total General PP&E			\$ 338,825,766	\$ (151,846,097)	\$ 186,979,669	\$ 181,547,138

¹Note 15 for additional information on Capital Leases

Legend for Valuation Methods:

S/L = Straight Line

N/A = Not Applicable

Fluctuations and Abnormalities

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for this reporting period.

Other Information Related to General PP&E, Net

The DON has the use of land, buildings, and other overseas facilities that are obtained through various international treaties and agreements negotiated by the Department of State. Generally, treaty terms allow the DON continued use of these properties until the treaties expire. There are no other known restrictions on General PP&E.

Military Equipment.

The Department changed its method of valuing military equipment in 3rd Quarter, FY 2006. Previously, military equipment was valued using Bureau of Economic Analysis (BEA) data. Beginning with the 3rd Quarter, FY 2006, military equipment is valued based on internal records. The value of military equipment for the 4th Quarter, FY 2005 was restated from \$140.3 billion to \$163.5 billion for comparative purposes using the new valuation method.

For 4th Quarter, FY 2006, military equipment is valued at \$170.3 billion based on internal records. Under the previously used BEA valuation methodology, this equipment would have been valued at \$143.7 billion.

Property in the Possession of Contractors.

The value of DON's General PP&E real property in the possession of contractors is included in the values

reported above for the Major Asset Classes of Land and Buildings, Structures, and Facilities. The value of General PP&E personal property (Major Asset Classes of Software and Equipment) does not include all of the General PP&E above DoD capitalization threshold in the possession of contractors. The net book amount of such property is immaterial in relation to the total General PP&E net book value. Per an approved strategy with Office of Management Budget (OMB), Government Accountability Office (GAO) and DoD Inspector General, DoD is developing new policies and a contractor reporting process to capture General PP&E information for future reporting purposes for compliance with Federal General Accepted Accounting Principles (GAAP). The DON does not have any General PP&E, for which the acquisition cost is unknown, therefore no valuation method to disclose.

Heritage Assets and Stewardship Land.

Relationship of Heritage Assets to Department of the Navy's (DON's) Mission.

The overall mission of DON is to control and maintain freedom of the seas; project power beyond the sea; and influence events and advance U.S. interests across the full spectrum of military operations. As this mission has been executed DON has become a large-scale owner of historic buildings, structures, districts, archeological sites and artifacts, ships, aircraft, and other cultural resources. Protection of these components of the nation's heritage is an essential part of DON's mission; DON is committed to responsible cultural resources stewardship.

Stewardship Policies for Heritage Assets and Description of Each Major Category of Heritage Assets.

The overall policy for DON's stewardship policies for heritage assets is contained in the Secretary of the Navy Instruction 4000.35A, "DON Cultural Resources Program."

- Heritage Assets are items that are unique for one of more of the following reasons: (1) historical or natural significance; (2) cultural, educational or artistic importance; or (3) significant architectural characteristics. The process used to define items as having heritage significance varies between categories and type of assets being evaluated. Subject matter experts, including historians and curators, play a significant role in the definition process. In all cases, a myriad of federal statutes, regulations, and other guidelines mandate heritage significance or provide guidance in its determination.
- Preservation considerations are incorporated into routine DON management of historic buildings, structures, districts, sites, ships, aircraft and other cultural resources. Compliance with cultural resources protection requirements is incorporated as appropriate into other DON planning processes, including but not limited to master planning, environmental planning, budgeting/programming, and facilities management. When functionally appropriate and economically prudent, DON gives preference to the rehabilitation or adaptive use of historic properties over new construction or leasing.
- The appropriate consultation is initiated with State Historic Preservation Officers, Tribal Historic Preservation Officers, Advisory Council on Historic Preservation, Native Americans, Native Hawaiians, and other interested agencies and publics whenever DON conducts or supports undertakings that may affect any National Register resource.
- DON designated staff maintain an awareness of specific legal obligations regarding its management of cultural resources such as establishing a program to locate and inventory all cultural resources under DON control and to evaluate them against National Register eligibility criteria for possible nomination to the National Register.
- Cultural resources management, including consultation, takes place at the lowest appropriate level in the chain of command.
- Archeological sites under the control of DON are excavated only to the extent required for evaluation and identification, unless scientific or programmatic considerations, or concerns about the integrity or security of a site, make more extensive excavation necessary or advisable.

- Archaeological Sites are locations that contain the remains of past human activity of various sorts that are listed or eligible for listing on the National Register of Historic Places.
- Buildings and Structures are listed as or determined eligible for listing on the National Register of Historic Places, including Multi-Use Heritage Assets.
- Cemeteries are government owned burial grounds on which gravesites of prominent historical figures may be located in addition to other gravesites.
- Major Collections include archeological artifacts that are maintained and inventoried by cubic feet, archival items that are maintained and inventoried by linear feet, and artwork and historical artifacts that are maintained and inventoried by individual items.
- Monuments and Memorials are those items that are built or placed to commemorate a person or event, preserve the memory of a historical event, or are shown or maintained for its historical interest.

Relationship of Stewardship Land to Department of the Navy's (DON's) Mission.

The overall mission of DON is to control and maintain freedom of the seas; project power beyond the sea; and influence events and advance U.S. interests across the full spectrum of military operations. As this mission has been executed DON has accumulated several hundred installations throughout the United States. These installations provide the capability to organize, train, and equip DON to perform its mission.

Stewardship Land Policy.

The DON Stewardship Land policy is the same as that which DON maintains over all land and installations. The DON strives to be a responsible steward of the land and to maintain it in a way that both protects human health and the environment and allows training and support of fleet readiness. The DON works to develop and improve partnerships with the communities in which its installations are located, the federal regulatory agencies such as U.S. Environmental Protection Agency, state regulatory agencies, and within the military services by sharing lessons learned and transfer of technologies.

Stewardship Land is defined as the type of land not acquired for or in connection with land, on which General Plant and Equipment is located. For DON, Stewardship Land includes land acquired through public domain, land set aside, and donated land. Some of this land is used as a buffer around the perimeter of DON installations and may include, but is not limited to, grazing lands and forestry maintenance areas.

Other Disclosures

Real Property.

The Internet Naval Facility Asset Database Store (iNFADS) provides real property values for financial statement reporting purposes.

Leasehold Improvements.

The DON's real property system iNFADS does not track leasehold improvements as a separate component of a building's total value. However, DON collects this information through a data call and began recognizing the leasehold improvement values beginning in FY 2004.

Software.

The DON uses the Defense Property Accountability System (DPAS) to capture costs associated with Internal Use Software.

Construction-in-Progress (CIP).

The CIP balances were obtained from the Facilities Information System (FIS). The value of construction that is performed for the benefit of external customers, such as Air Force and several of the Defense Agencies, is provided to Air Force, the Defense Agencies, and the Defense Finance and Accounting Service. The value of construction for external customers is not included in DON CIP balances.

Preponderant Use.

Per the DoD FMR, Volume 4, Chapter 6, legal ownership is not always the determinant factor when establishing which DoD Component recognizes a particular General PP&E asset for accounting and reporting purposes. If the following four criteria are met, the preponderant user should report the property regardless of legal ownership or funding source:

- The asset embodies a probable future benefit;
- The DoD Component that reports the asset obtains the benefit and controls access to the benefit inherent in the asset;
- The transaction or event giving the Component the right to, and control over, the benefit has already occurred; and
- The predominantly used assets, taken as a whole, are material to the Component's financial statements.

In accordance with an Office of the Under Secretary of Defense (Comptroller) memorandum of July 5, 2005, the military departments and DoD activities meeting the criteria of preponderant user are responsible for reconciliation of preponderant use property. A milestone of the DON Financial Improvement Plan (FIP) is to reconcile with DoD activities and to ensure that the DON real property database recognizes the preponderant user. As these efforts are completed and reconciliations are documented, DON General Fund will make the adjustments to the General Property, Plant and Equipment line.

Assets Under Capital Lease

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Entity as Lessee, Assets Under Capital Lease		
A. Land and Buildings	\$ 0	\$ 0
B. Equipment	115	0
C. Accumulated Amortization	(11)	0
D. Total Capital Leases	\$ 104	\$ 0

2. Description of Lease Arrangements

Leased assets consist primarily of personal property reported in the DPAS system.

3. Other Information Related to Assets under Capital Lease

The DON reported a net increase of \$104 thousand, 100%, in Assets under Capital Lease in FY 2006. No capital leases existed in FY 2005, but one new lease was reported beginning 1st Quarter FY 2006.

Note 11. Liabilities Not Covered by Budgetary Resources

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Intragovernmental Liabilities		
A. Accounts Payable	\$ 0	\$ 0
B. Debt	0	0
C. Other	3,770,838	3,162,677
D. Total Intragovernmental Liabilities	\$ 3,770,838	\$ 3,162,677
2. Nonfederal Liabilities		
A. Accounts Payable	\$ 37,299	\$ 28,049
B. Military Retirement and Other Federal Employment Benefits	1,513,644	1,532,819
C. Environmental Liabilities	16,773,218	16,513,000
D. Other Liabilities	3,735,957	3,550,457
E. Total Nonfederal Liabilities	\$ 22,060,118	\$ 21,624,325
3. Total Liabilities Not Covered by Budgetary Resources	\$ 25,830,956	\$ 24,787,002
4. Total Liabilities Covered by Budgetary Resources	\$ 5,461,997	\$ 4,470,889
5. Total Liabilities	\$ 31,292,953	\$ 29,257,891

Fluctuations and Abnormalities

Intragovernmental Liabilities.

Total intragovernmental liabilities increased \$608.2 million, 19%, in FY 2006. A receivable of \$345.6 million that was classified in FY 2005 as “currently not collectible” was not reported as a nonentity receivable. The DON began reporting this as an active nonentity receivable in the 1st Quarter, FY 2006 due to a change in the litigation status. Furthermore, in 4th Quarter FY 2005, \$210.8 million of out-of-service debt that should have been classified as nonentity was erroneously classified as an entity receivable. This classification error was corrected in 1st Quarter, FY 2006. The offsetting entry for these nonentity receivables is a liability to Department of Treasury. The associated accounts receivable balances are remitted to Treasury upon collection, and thus considered a liability to DON.

Nonfederal Liabilities.

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for this reporting period.

An explanation of fluctuations and abnormalities for Total Liabilities Covered by Budgetary Resources is included in the specific note for that liability. See Notes 12 through 17.

Definitions

- Liabilities Covered by Budgetary Resources are those that are incurred by the reporting entity, which are covered by realized budgetary resources as of the balance sheet date. Budgetary

resources encompass not only new budget authority, but also other resources available to cover liabilities for specified purposes in a given year.

- Realized budgetary resources include:
 - (1) New budget authority
 - (2) Spending authority from offsetting collections (credited to an appropriation or fund account)
 - (3) Recoveries of unexpired budget authority through downward adjustments of prior year obligations
 - (4) Unobligated balances of budgetary resources at the beginning of the year or net transfers of prior year balances during the year, and
 - (5) Permanent indefinite appropriations or borrowing authority, which have been enacted and signed into law as of the balance sheet date, provided that the resources may be apportioned by OMB without further action by the Congress or without a contingency first having to be met.
- Conversely, Liabilities Not Covered by Budgetary Resources are those liabilities which are not considered covered by realized budgetary resources as of the balance sheet date. Budgetary Authority to satisfy these liabilities is expected to be provided in a future Defense Appropriations Act. When that future budgetary authority is provided, these respective liabilities will be recorded as Covered by Budgetary Resources with an associated funded expense. To prevent overstatement on the Balance Sheet and Statement of Net Cost, the liabilities previously recorded as Not Covered by Budgetary Resources and the associated unfunded expenses are reversed.

Other Disclosures

Military Retirement Benefits and Other Employment Related Actuarial Liabilities (Line 2.B) includes \$1.5 billion in Federal Employee's Compensation Act (FECA) liabilities.

Intragovernmental Liabilities – Other (Not covered by Budgetary Resources) (Line 1.C) includes the following:

As of September 30, 2006

(Amounts in thousands)

Federal Employees'

Compensation Act (FECA)	\$557,343
Unemployment	71,447
Liabilities to Treasury	3,142,048
Total	<u>\$3,770,838</u>

Liabilities to Treasury.

The primary component of the \$3.1 billion liability to Treasury is a principal amount of \$1.3 billion, representing advance payments made to contractors and \$1.3 billion in associated accrued interest which remains in litigation. This amount in litigation is reported as an unfunded liability to Department of the Treasury. Collections on this debt will be due and payable to Treasury as the original appropriation is in a cancelled status. See Notes 2 and 5 for further disclosure.

Nonfederal Liabilities – Other (Not covered by Budgetary Resources) (Line 2.D) includes the following:

As of September 30, 2006

(Amounts in thousands)

Annual Leave	\$2,738,551
Military Equipment – Non-nuclear Non	
Environmental Disposal Liabilities	285,200
Disposal Liabilities for Excess/Obsolete Structures	635,835
Contract Incentives	76,371
Total	<u>\$3,735,957</u>

Note 12. Accounts Payable

As of September 30	2006			2005
	Accounts Payable	Interest, Penalties, and Administrative Fees	Total	Total
(Amounts in thousands)				
1. Intragovernmental Payables	\$ 1,035,043	\$ N/A	\$ 1,035,043	\$ 1,208,703
2. Nonfederal Payables (to the Public)	1,265,536	0	1,265,536	1,180,034
3. Total	<u>\$ 2,300,579</u>	<u>\$ 0</u>	<u>\$ 2,300,579</u>	<u>\$ 2,388,737</u>

4. Other Information Related to Accounts Payable

Fluctuation and Abnormalities

Intragovernmental Payables.

The DON reported a decrease of \$173.7 million, 14%, in Intragovernmental payables in FY 2006. The trading partner process largely drives the balances in Intragovernmental payables. Upon receipt of accounts receivable data reported by our trading partners, DON records compensating accounts payable. For agencies that do not provide account receivable data, DON records accounts payable estimates based upon historical data. The total Level One (business conducted with other Federal Agencies) Intragovernmental accounts payable amount recorded in FY 2006 was \$347.8 million. The Level One estimate is updated quarterly.

The majority of the decrease was with the General Services Administration and Department of Energy (Level One) for the amounts of \$50.3 million and \$10.3 million respectively, as a result of improving the oversight for non-Economy Act orders. The decrease with the Navy Working Capital Fund (Level Two, business conducted with other DoD organizations) for the amount of \$85.0 million was a result of implementing a business practice that allowed the NWCF to charge the appropriations directly when making contract payments. This change took place throughout FY 2006.

Nonfederal Payables.

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for this reporting period.

Definitions

Intragovernmental Accounts Payable.

This line consists of amounts owed to other federal agencies for goods or services ordered and received but not yet paid. Interest, penalties and administrative fees are not applicable to intragovernmental payables.

Nonfederal Payables (to the Public).

This line represents amounts owed to nonfederal government entities and individuals.

Undistributed Disbursements.

Undistributed Disbursements are the difference between disbursements recorded at the detailed level to a specific obligation or payable in the activity field records versus those reported by the Department of the Treasury. This should agree with the undistributed disbursements reported on monthly accounting reports. Generally, timing issues between systems cause undistributed disbursements. In-transit disbursements are payments that have been made by other agencies, entities, or systems that have not yet been recorded in DON's accounting records. For FY 2006, total supported undistributed disbursements were \$1.8 billion.

Intragovernmental Elimination.

Regarding interagency purchases; DON accounting systems do not capture trading partner data at the transaction level in a manner that facilitates trading partner aggregations. Therefore, DON was unable to fully reconcile intragovernmental accounts payable to the related intragovernmental accounts receivable, on another agencies' records that generated the payable.

Therefore, DoD summary level seller accounts receivables were compared to DON's accounts payable. An adjustment was posted to DON's accounts payable based on the comparison with the accounts receivable of DoD Components providing goods and services to DON.

The DoD intends to develop long-term systems improvements that will include sufficient up-front edits and controls to eliminate the need for after-the-fact reconciliations. The volume of intragovernmental transactions is so large that after-the-fact reconciliation cannot be accomplished with existing or foreseeable resources. In the interim, DFAS is leading an effort to identify alternative means of capturing and recognizing buyer side trading partner data.

Other Disclosures

Payables, more than any other liability, are subject to the vagaries of the business cycle, contract terms, the timing of the receipt of invoices for goods and services, and the subsequent liquidation of those invoices; thus variances from the previous reporting period are not uncommon. Payables are temporary liabilities and are expected to be liquidated within the next payment cycle.

Judgment Fund Liabilities.

The DON must reimburse the Department of the Treasury for payments made from the Judgment Fund on its behalf. These payments are a result of claims being resolved under the Contracts Dispute Act. In addition, the Notification of Federal Antidiscrimination and Retaliatory Act (No FEAR) was implemented on October 1, 2003. This law requires all agencies to reimburse the Judgment Fund for cases covered by the No FEAR Act. For FY 2006, DON reported \$167.0 thousand for No FEAR Act liabilities.

Note 13. Debt

Not Applicable.

Note 14. Environmental Liabilities and Disposal Liabilities

As of September 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
<i>(Amounts in thousands)</i>				
1. Environmental Liabilities--Nonfederal				
A. Accrued Environmental Restoration Liabilities				
1. Active Installations—Installation Restoration Program (IRP) and Building Demolition and Debris Removal (BD/DR)	\$ 330,987	\$ 1,998,233	\$ 2,329,220	\$ 2,666,516
2. Active Installations—Military Munitions Response Program (MMRP)	54,700	630,300	685,000	554,455
3. Formerly Used Defense Sites—IRP and BD/DR	0	0	0	0
4. Formerly Used Defense Sites--MMRP	0	0	0	0
B. Other Accrued Environmental Liabilities—Active Installations				
1. Environmental Corrective Action	0	40,637	40,637	0
2. Environmental Closure Requirements	289	185,544	185,833	0
3. Environmental Response at Operational Ranges	0	0	0	0
4. Other	0	0	0	0
C. Base Realignment and Closure (BRAC)				
1. Installation Restoration Program	98,805	1,018,288	1,117,093	1,079,256
2. Military Munitions Response Program	11,103	101,746	112,849	65,236
3. Environmental Corrective Action / Closure Requirements	18,074	49,388	67,462	0
4. Other	0	0	0	0
D. Environmental Disposal for Weapons Systems Programs				
1. Nuclear Powered Aircraft Carriers	0	5,604,268	5,604,268	6,426,100
2. Nuclear Powered Submarines	0	3,377,665	3,377,665	5,837,200
3. Other Nuclear Powered Ships	0	277,608	277,608	223,900
4. Other National Defense Weapons Systems	0	233,772	233,772	197,788
5. Chemical Weapons Disposal Program	0	0	0	0
6. Other	0	3,237,406	3,237,406	0
2. Total Environmental Liabilities	\$ 513,958	\$ 16,754,855	\$ 17,268,813	\$ 17,050,451

Fluctuations and Abnormalities

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for this reporting period.

In addition to the liabilities reported above, the Department of the Navy (DON) has the potential to incur costs for restoration initiatives in conjunction with returning overseas Defense facilities to host nations. The DON is unable to provide a reasonable estimate at this time because the extent of restoration required is not known.

Other Category Disclosure Comparative

	2006	2005
<i>(Amounts in thousands)</i>		
Other Accrued Environmental Costs- Other	\$0	\$0
Total	\$0	\$0
Base Realignment and Closure- Other	\$0	\$0
Total	\$0	\$0
Environmental Disposal for Weapon Systems Programs- Other- Spent Nuclear Fuel	\$3,237,406	\$0
Total	\$3,237,406	\$0

The “Other” type of environmental liabilities is Spent Nuclear Fuel (Line1.D.6). Per a Government Accountability Office audit recommendation and completion of a milestone of the DON Financial Improvement Program, DON began recognizing an estimated environmental disposal liability associated with Spent Nuclear Fuel during 3rd Quarter, FY 2006. Spent Nuclear Fuel is the used fuel that is removed from the nuclear reactors of nuclear powered ships and submarines. The estimate includes shipping, processing, and storing the spent nuclear fuel. The total estimated liability for spent nuclear fuel is \$3.2 billion.

Other Information Related to Environmental Liabilities

1. Applicable Laws and Regulations of Cleanup Requirements

The following is a summary of significant laws that affect DON’s conduct of environmental policy and regulations.

The National Environmental Policy Act (NEPA) of 1970 requires DON to consider the environmental impacts of proposed actions in the decision making process. Per DON regulations, the action proponent will determine the level or amount of NEPA documentation required. The Resource Conservation and Recovery Act (RCRA) of 1976 as amended by the Hazardous and Solid Waste Amendments (HSWA) of 1984, was the first comprehensive federal effort to deal with safe disposal of all types of hazardous wastes, and provides for “cradle to grave” tracking of hazardous wastes. Permits are required for treatment, storage or disposal. Requirements for underground storage tanks (USTs) are also contained in RCRA.

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), commonly referred to as the Superfund legislation, provided Federal agencies authority to respond to the release or the substantial threat of release of hazardous substances into the environment. CERCLA was amended several times; one of the amendments was the Superfund Amendments and Reauthorization Act (SARA) of 1986. This amendment established procedures to ensure that actual or threatened hazardous substance releases have proper responses. The procedures address reporting, investigations, remedy selection, and responsive provisions. Another amendment to CERCLA was the Community Environmental Response Facilitation Act (CERF) of 1992. The DON must identify real property on each facility that is not contaminated and that offers the greatest opportunity for expedited reuse and redevelopment. When property is transferred, DON is still responsible for any remediation or corrective action or any response action found to be necessary after the transfer.

The Clean Water Act (CWA) of 1977, Section 405 Disposal of Sewage Sludge, amended the Federal Water Pollution Control Act. The purpose of CWA is to restore and maintain the integrity of the nation’s waters. The CWA implementing regulations established closure and post closure requirements for sewage sludge disposal. To help protect the nation’s drinking water supply, including underground injections through a permitting scheme, is the purpose of the Safe Drinking Water Act of 1974 (Well Head Protection Areas).

The Clean Air Act (CAA) of 1990 established standards/limitations to prevent and control air pollutant discharges that could harm human health and natural resources. Requirements ensure that units can no longer operate when they are shutdown. Finally, the Toxic Substances Control Act (TSCA) of 1976 was implemented to understand the health risks of chemical substances by developing production and health risk data from the manufacturers. Based on the data, the Environmental Protection Agency has promulgated regulations for specific chemicals. The control of polychlorinated biphenyls (PCBs) is a good example. The control addresses spill cleanup and removal and disposal of units containing PCBs.

For the nuclear powered aircraft carriers and submarines, other nuclear powered ships, and spent nuclear fuel, the following significant laws affect DON's conduct of environmental policy and regulations. The Atomic Energy Act of 1954, as amended, assures the proper management of source, special nuclear, and byproduct material. As in all cases with nuclear power, DON coordinates all actions with the Department of Energy. The Nuclear Waste Policy Act of 1982 required all owners and generators of high-level nuclear waste and spent nuclear fuel, to pay their respective shares of the full cost of the program. Finally, the Low Level Radioactive Waste Policy Amendments Act of 1986 provides for the safe and efficient management of low-level radioactive waste.

2. Methods for Assigning Total Cleanup Costs to Current Operating Periods

Accrued Environmental Restoration (Defense Environmental Restoration Program (DERP) Funded Liabilities.

Active Installations – Environmental Restoration (ER): Accrued restoration (cleanup) liabilities represent the cost to correct past environmental areas that are funded under the Defense Environmental Restoration Program in accordance with "Management Guidance for DERP," and "Environmental and Non-Environmental Liabilities," Chapter 13 of Volume 4 of Department of Defense Financial Management Regulation (DoD FMR). These liabilities relate to Plant, Property and Equipment, including acquired land and Stewardship Land, as those major asset categories are described in Chapter 6 of Volume 4 of DoD FMR. Environmental restoration activities may be conducted at operating installations, at Formerly Used Defense Sites (FUDS), and at Closed, Transferred, and Transferring Ranges. Environmental restoration measurements involve the use of cost estimates that consider, on a current cost basis, the anticipated costs of the level of effort required to affect the restoration, as well as applicable legal and/or regulatory requirements. Program management and support costs are included in the estimates. The estimates are based on DON's cost-to-complete (CTC) module of the Normalization of Data System (NORM). Verification, validation, and accreditation (VV&A) of CTC module was completed in FY 2002. Such cost estimates are based on the current technology available. The DON, as the baseline for environmental restoration (cleanup) liability measurement (i.e., the current cost to acquire the required services), used the site inventory and estimated cost data prepared for DERP report to the Congress. The Accrued Environmental Restoration (Cleanup) Costs do not include the costs of environmental compliance; pollution prevention, conservation activities, contamination or spills associated with current operations or treaty obligations, all of which are accounted for as part of ongoing operations. The DON Environmental Restoration (ER, N) Program includes 3,700 clean-up sites at active installations while those installations covered by Base Realignment and Closure (BRAC) funding include 1,148 clean-up sites. The Marine Corps is included in these programs. In addition, the DON Environmental Corrective Action Program at BRAC installations included 610 sites.

Active Installations – Military Munitions Response Program: This area represents the environmental liabilities associated with the identification, investigation and removal and remedial actions to address environmental contamination at ranges that were closed prior to September 30, 2002. The contamination may include munitions, chemical residues from military munitions and munitions scrap at ranges on active installations that pose a threat to human health or the environment. The amount reported is the portion of the liability that can be estimated based on site level investigations and characterizations. The estimate produced is based on site-specific information and use of cost models validated in accordance with DoD Instruction 5000.61, "DoD Modeling and Simulation (M&S) Verification, Validation, and

Accreditation (VV&A)" of May 2003. Total liabilities (cost-to-complete) are not estimated until there is sufficient site-specific data available to estimate the total liability. However, the DON uses the cost of the study as the estimate until the study is completed. Beginning in FY 2001, DON began an inventory of closed ranges and transferring ranges under the Military Munitions Response Program (MMRP) or Unexploded Ordnance (UXO) program. The inventory was completed September 2002 and currently contains 216 closed ranges at active installations and 28 sites (transferring ranges) at BRAC installations.

Environmental Disposal for Weapons Systems Programs: This area represents environmental liabilities associated with the Nuclear Powered Aircraft Carriers and Submarines, Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel. During FY 2006, under DON Financial Improvement Program, DON completed a review of the estimating methodology for determining the cost for disposal of ships and submarines. This review resulted in an environmental and nonenvironmental liability estimate, that more accurately reflects the true costs of disposal. The estimating methodology is based on average cost per class of ship rather than an average applied to all ships regardless of class. This change in estimating methodology resulted in an overall decrease in the estimated environmental liability for nuclear powered ships and submarines and conventional ships in 3rd Quarter, FY 2006. However this decrease was offset by recognizing an estimated liability for spent nuclear fuel beginning in 3rd Quarter, FY 2006.

3. Description of the Types of Environmental Liabilities and Disposal Liabilities

Accrued Environmental Restoration (DERP Funded) Cost Liabilities.

The DON Environmental Restoration includes those sites that have been identified as legacy cleanup sites. For FY 2006, DON estimated and reported \$3.0 billion for environmental restoration liabilities. This amount is comprised of \$2.3 billion in Active Installations - Environmental Restoration (ER) liabilities and \$685.0 million in Active Installations - ER for Closed Ranges, liabilities, which represents UXO. The DoD FMR, Volume 6B, Chapter 10 requires that "any estimate produced must be based on site specific information and use cost models validated in accordance with DoD Instruction 5000.61." The DON is supporting this requirement by continuing to validate its range inventory as well as by pursuing the process of obtaining valid cost estimates for each range.

Other Accrued Environmental Costs (Non-DERP funds).

The DON defines Non-DERP environmental units as those sites associated with on-going operations such as solid waste management unit cleanup, landfill closure, permitted facilities, removal, replacement, retrofill, and/or disposal of polychlorinated biphenyls (PCBs) transformers, underground storage tank remedial investigation and closure. As part of the DON Financial Improvement Program efforts, DON completed surveying, identifying, and estimating, Non-DERP units and expects to recognize the estimate 1st Quarter FY 2007. The Marine Corps completed its survey of on-going operations and their estimated total liability for Non-DERP is \$226.5 million.

Base Realignment and Closure (BRAC).

BRAC environmental sites are environmental sites at DON installations that are or will be closed under the congressionally mandated Base Realignment and Closure process. For FY 2006, DON estimated and reported \$1.2 billion for BRAC funded environmental restoration liabilities. This amount includes \$1.1 billion for environmental restoration (ER) program, \$112.8 million for Military Munitions Response Program, and \$67.5 million for corrective action and closure requirements. Military Munitions Response Program includes military munitions, chemical residues from military munitions, and munitions scrap at locations on or associated on or associated with a military range on a BRAC installation.

Environmental Disposal for Weapons Systems Programs.

Environmental Disposal for Weapon Systems are those estimates associated with the environmental disposal costs for DON nuclear weapons programs that includes Nuclear Powered Aircraft Carriers and Submarines and Other Nuclear Powered Ships, Conventional Ships, and Spent Nuclear Fuel. The

DON reported an environmental disposal liability for Weapons Systems Programs of \$12.7 billion in FY 2006. This amount includes nuclear powered aircraft carriers of \$5.6 billion, nuclear powered submarines of \$3.4 billion, other nuclear powered ships of \$277.6 million, other national defense weapons systems (conventional ships) of \$233.7 million, and spent nuclear fuel (Other) of \$3.2 billion.

4. Nature of Estimates and the Disclosure of Information Regarding Possible Changes due to Inflation, Deflation, Technology, or Applicable Laws and Regulations

For both current and prior periods, the changes due to price growth (inflation) and increases in labor rates and materials have been offset by a change in the estimating methodology for weapons systems. This change in estimating methodology resulted in an overall decrease in the estimated environmental disposal liability. However, this decrease was offset by recognizing an estimated liability for spent nuclear fuel during 3rd Quarter, FY 2006. Currently, there are no indications that any of the environmental liabilities for any category will be adjusted due to deflation. As of FY 2006, there are no changes to the environmental liability estimates due to changes in laws, regulations, and in agreements with regulatory agencies. The DON does not have any estimates that were changed due to advances in technology.

5. Description of the Level of Uncertainty Regarding the Accounting Estimates used to calculate the Reported Environmental Liabilities

The environmental liabilities for DON are based on accounting estimates that require certain judgments and assumptions that DON believes are reasonable based upon information available to us at the time of calculating the estimates. The actual results may vary materially from the accounting estimates if agreements with regulatory agencies require remediation to a different degree than anticipated when calculating the estimates. The liabilities can be further impacted if further investigation of the environmental sites discloses contamination different than known at the time of the estimates.

Overall, DON has a reasonable level of confidence in the estimates recognized on the face of the financial statements. This reasonable level of confidence in the estimates is based on the fact that the estimates for DERP/BRAC programs are based on the Cost to Complete (CTC) module of the NORM System. A verification, validation, and accreditation was completed by a third party for CTC module of NORM, while the environmental program managers continue to validate the data. For the Weapons systems, the environmental program managers base their environmental disposal estimates on actual costs for similar projects. A change in the overall methodology in weapons systems reflects a more accurate estimate of what it will cost to dispose of the weapons systems. Given the fact that the planned date for opening the Department of Energy's (DOE) planned waste repository has been delayed, there is uncertainty associated with the estimate for spent nuclear fuel. As DOE's plans are solidified, DON's estimates for spent nuclear fuel will change accordingly.

The DON believes that the current environmental liabilities for BRAC are reasonable based upon information available at the time of calculating the estimates. However, as the FY 2005 BRAC closure activities are implemented over the next several fiscal years, the actual results may vary materially from the accounting required estimates. The variance will depend on additional information gleaned from planned or ongoing studies of the extent and concentration of site environmental contamination. In addition to the possibility of the estimates changing on current identified sites, DON may incur additional environmental cleanup and restoration costs if new sites are identified as BRAC activities are implemented.

Environmental Disclosures

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
A. Amount of operating and capital expenditures used to remediate legacy waste. Legacy wastes are the remediation efforts covered by IRP, MMRP, and BD/DR regardless of funding source.	567,536	356,165
B. The unrecognized portion of the estimated total cleanup costs associated with general property, plant, and equipment.	1,423,683	0
C. The estimated cleanup costs associated with general property, plant, and equipment placed into service during each fiscal year.	0	0
D. Changes in total cleanup costs due to changes in laws, regulations, and/or technology.	0	0
E. Portion of the changes in estimated costs due to changes in laws and technology that is related to prior periods.	0	0

Explanations

Line A. For FY 2006, of the total \$567.5 million, \$296.4 million is related to DERP while \$271.1million is related to BRAC corrective action and restoration programs. When compared with FY 2005, the increase of \$211.4 million, 59% is a result of increased funding (BRAC appropriation and increased revenue from land sales) and therefore the BRAC office was able throughout FY 2006 to execute a greater amount of environmental corrective actions and environmental restoration cleanup than in FY 2005.

Line B. The unrecognized portion of the estimated total cleanup costs is associated with Nuclear Powered Carriers and Submarines, Conventional Ships, Spent Nuclear Fuel, and Non-DERP. Of the total, \$36.0 million is associated with conventional ships while the remainder, \$1.3 billion is associated with Nuclear Powered Carriers and Submarines and Spent Nuclear Fuel and \$14.3 million is associated with Non-DERP. For FY 2005, DON was not accruing the liability as required by DoD FMR, Volume 4, Chapter 13 and therefore did not have any unrecognized portion for Weapons Systems Programs and Non-DERP environmental liabilities.

Line C. For FY 2005, DON recognized the entire environmental liability for Weapons Systems Programs and did not accrue the liability. For FY 2006, DON can determine the unrecognized portion, and is working on a methodology to identify the individual assets and units by year. This effort will be completed by 2nd Quarter FY 2007.

Lines D. and E. Through our quarterly data call process, DON determined that there are no changes to the environmental liability estimates due to changes in laws, regulations, in agreements with regulatory agencies, and advances in technology for both FY 2005 and FY 2006.

Note 15. Other Liabilities

As of September 30	2006			2005
	Current Liability	Noncurrent Liability	Total	Total
<i>(Amounts in thousands)</i>				
1. Intragovernmental				
A. Advances from Others	\$ 0	\$ 0	\$ 0	\$ 0
B. Deposit Funds and Suspense Account Liabilities	474,507	0	474,507	311,227
C. Disbursing Officer Cash	176,306	0	176,306	305,441
D. Judgment Fund Liabilities	0	0	0	0
E. FECA Reimbursement to the Department of Labor	237,791	319,552	557,343	554,280
F. Other Liabilities	3,251,997	0	3,251,997	2,655,100
G. Total Intragovernmental Other Liabilities	\$ 4,140,601	\$ 319,552	\$ 4,460,153	\$ 3,826,048
<i>(Amounts in thousands)</i>				
2. Nonfederal				
A. Accrued Funded Payroll and Benefits	\$ 445,018	\$ 0	\$ 445,018	\$ 566,829
B. Advances from Others	205,544	0	205,544	151,215
C. Deferred Credits	0	0	0	0
D. Deposit Funds and Suspense Accounts	42,257	0	42,257	0
E. Temporary Early Retirement Authority	0	0	0	0
F. Nonenvironmental Disposal Liabilities				
(1) Military Equipment (Nonnuclear)	0	285,201	285,201	683,514
(2) Excess/Obsolete Structures	59,412	626,206	685,618	235,897
(3) Conventional Munitions Disposal	0	0	0	0
G. Accrued Unfunded Annual Leave	2,738,551	0	2,738,551	2,650,745
H. Capital Lease Liability	0	0	0	0
I. Other Liabilities	181,648	1,165,927	1,347,575	171,636
J. Total Nonfederal Other Liabilities	\$ 3,672,430	\$ 2,077,334	\$ 5,749,764	\$ 4,459,836
3. Total Other Liabilities	\$ 7,813,031	\$ 2,396,886	\$ 10,209,917	\$ 8,285,884

Fluctuations and Abnormalities

Intragovernmental Other Liabilities.

Total intragovernmental liabilities increased \$634.1 million, 17%, in FY 2006. A receivable of \$345.6 million that was classified in FY 2005 as “currently not collectible” was not reported as a nonentity receivable. The DON began reporting this as an active nonentity receivable in the 1st Quarter, FY 2006 due to a change in the litigation status. Furthermore, in 4th Quarter FY 2005, \$210.8 million of out-of-service debt that should have been classified as nonentity was erroneously classified as an entity receivable. This classification error was corrected in 1st Quarter, FY 2006. The offsetting entry for these nonentity receivables is a liability to Department of Treasury. The associated accounts receivable balances are remitted to Treasury upon collection, thus considered a liability to DON.

Nonfederal Other Liabilities.

The DON reported an increase of \$1.3 billion, 29%, in Nonfederal Other Liabilities in FY 2006. In 4th Quarter FY 2006, in accordance with a DoD policy decision based on a DoD Inspector General audit finding, DON began recording an estimated contingent liability (and corresponding asset) for the value of unbilled contractor costs on specified contracts. This contingent liability balance includes \$1.1 billion in estimated contract financing payments that will be paid to the contractor upon delivery and Government acceptance of a satisfactory product. In accordance with contract terms, specific rights to the contractor’s work vests with the Government when a specific type of contract financing payment is made, thereby protecting taxpayer funds in the event of contract nonperformance. These rights should not be misconstrued as the rights of ownership. The Department is under no obligation to pay the contractor for amounts greater than the amounts authorized in the contract until delivery and Government acceptance of a satisfactory product. Because it is probable that the contractor will complete its efforts and deliver a satisfactory product to the Department and the amount of potential payments are estimable, the Department has recognized a contingent liability for estimated payments, which are conditional pending delivery and Government acceptance of a satisfactory product.

Other Disclosures

In response to the Department of Defense, Inspector General audit, “Financial Management: DoD Process for Reporting Contingent Legal Liabilities”, the DON developed a methodology during 4th Quarter FY 2006 that provides an estimate for those legal cases that are considered probable or reasonably possible to be settled against the government. The DON is testing the methodology with the objective to begin reporting in 2nd Quarter FY 2007.

For FY 2006, the DON does not have any delinquent amounts due to the Department of Labor (DOL) for the FECA bill. The FY 2007 FECA bill is due to DOL 30 days after the appropriation bill is passed and signed.

Intragovernmental Other Liabilities:

Other Liabilities - Other (Line 1.F) includes the following:

As of September 30, 2006	
<i>(Amounts in thousands)</i>	
Liability to Treasury & Others	\$3,144,045
Unemployment	71,447
Employment Benefit	36,505
Total Intragovernmental Other Liabilities	<u>\$3,251,997</u>

Nonfederal Other Liabilities:

Other Liabilities - Other (Line 2.I) includes the following:

As of September 30, 2006	
<i>(Amounts in thousands)</i>	
Contract Holdbacks	\$151,188
Litigation Settlement	\$4,000
Employer Contributions (taxes)	3,508
Contract Incentives	76,371
Liability for In-Process Assets	1,112,508
Total Intragovernmental Other Liabilities	<u>\$1,347,575</u>

Capital Lease Liability

Not applicable.

Note 16. Commitments and Contingencies**Legal Contingencies:**

The Department of the Navy (DON) is a party in various administrative proceedings and legal actions, with claims including environmental damage claims, equal opportunity matters, and contractual bid protests. These proceedings and actions arise in the normal course of operations and their ultimate disposition is unknown. The DON will accrue contingent liabilities for legal actions in those instances where the DON's Office of General Counsel considers an adverse decision probable and the amount of loss is measurable. In the event of an adverse judgment against the Government, some of the liabilities may be payable from the Judgment Fund. Others may be payable from DON's resources, either directly or by reimbursement to the Judgment Fund. The DON records Judgment Fund liabilities in Accounts Payable, which are detailed in Note 12.

For fiscal years 2006 and 2005, the DON General Fund materiality threshold for reporting litigation, claims, or assessments was \$56.1 million and \$53.2 million, respectively. Based on information contained in the FY 2006 Preliminary and Final Legal Representation Letters, management does not have sufficient reason to believe that it is likely that the Government will be liable for the amounts claimed in individual or aggregated cases.

The DON currently has sixteen cases; fifteen against the Navy and one against the United States Marine Corps, that meet the FY 2006 DON General Fund materiality threshold. DON legal counsel was unable to express an opinion concerning the likely outcome of these sixteen cases. Therefore, no contingent liabilities were accrued nor is any disclosure of estimated contingencies required. This declaration is fully supported by the Preliminary and Final Legal Representation letters and the subsidiary management summary schedule.

In response to the Department of Defense, Inspector General audit, "Financial Management: DoD Process for Reporting Contingent Legal Liabilities", the DON developed a methodology during 4th Quarter FY 2006 that provides an estimate for those legal cases that are considered probable or reasonably possible to be settled against the government. The DON is testing the methodology with the objective to begin reporting in 2nd Quarter FY 2007.

Other Commitments and Contingencies

The DON has recorded a contingent liability in the amount of \$37.3 million for obligations related to cancelled appropriations.

The DON has recorded a contingent liability in the amount of \$76.4 million for Contract Incentives.

Note 17. Military Retirement and Other Federal Employment Related Benefits

As of September 30	2006				2005
	Present Value of Benefits	Assumed Interest Rate (%)	(Less: Assets Available to Pay Benefits)	Unfunded Liability	Present Value of Benefits
<i>(Amounts in thousands)</i>					
1. Pension and Health Actuarial Benefits					
A. Military Retirement Pensions	\$ 0		\$ 0	\$ 0	\$ 0
B. Military Retirement Health Benefits	0		0	0	0
C. Military Medicare-Eligible Retiree Benefits	0		0	0	0
D. Total Pension and Health Actuarial Benefits	\$ 0		\$ 0	\$ 0	\$ 0
2. Other Actuarial Benefits					
A. FECA	\$ 1,513,644		\$ 0	\$ 1,513,644	\$ 1,532,819
B. Voluntary Separation Incentive Programs	0		0	0	0
C. DoD Education Benefits Fund	0		0	0	0
D. Total Other Actuarial Benefits	\$ 1,513,644		\$ 0	\$ 1,513,644	\$ 1,532,819
3. Other Federal Employment Benefits	\$ 0		\$ 0	\$ 0	\$ 0
4. Total Military Retirement and Other Federal Employment Benefits:	\$ 1,513,644		\$ 0	\$ 1,513,644	\$ 1,532,819

Actuarial Cost Method Used:

Assumptions:

Market Value of Investments in Market-based and Marketable Securities:

Fluctuation and Abnormalities

There are no abnormalities to disclose and no variances equal to or greater than ten percent and or two percent of total assets to explain for this reporting period.

Other Information Related to Military Retirement Benefits and Other Employment Related Actuarial Liabilities

Military Retirement Pensions.

The portion of the military retirement benefits actuarial liability applicable to DON is reported on the financial statements of the Military Retirement Fund (MRF).

Military Retirement Health Benefits.

Health benefits are funded centrally at the DoD level. As such, the portion of the health benefits actuarial liability that is applicable to DON is reported only on the DoD Agency-wide financial statements.

Federal Employees' Compensation Act (FECA).

Actuarial Cost Method Used and Assumptions:

The DON's actuarial liability for workers' compensation benefits is developed by the Department of Labor and provided to DON at the end of each fiscal year. The liability for future workers' compensation (FWC) benefits includes the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. Consistent with past practice, these projected annual benefit payments have been discounted to present value using the Office of Management and Budget's economic assumptions for 10-year Treasury notes and bonds. Interest rate assumptions utilized for discounting were as follows:

FY 2006

5.170 % in Year 1

5.313 % in Year 2 and thereafter

To provide more specifically for the effects of inflation on the liability for future workers' compensation benefits, wage inflation factors (cost of living adjustments or COLAs) and medical inflation factors (consumer price index medical or CPIMs) were applied to the calculation of projected future benefits. The actual rates for these factors for the charge back year (CBY) 2006 were also used to adjust the methodology's historical payments to current year constant dollars.

The compensation COLAs and CPIMs used in the projections for various charge back years (CBY) were as follows:

CBY	COLA	CPIM
2006	3.50%	4.00%
2007	3.13%	4.01%
2008	2.40%	4.01%
2009	2.40%	4.013%
2010+	2.43%	4.09%

The model's resulting projections were analyzed to insure that the estimates were reliable. The analysis was based on four tests: (1) a sensitive analysis of the model to economic assumptions, (2) a comparison of the percentage change in the liability amount by agency to the percentage change in the actual incremental payments, (3) a comparison of the incremental paid losses per case (a measure of case-severity) in CBY 2006 to the average pattern observed during the most current three charge back years, and (4) a comparison of the estimated liability per case in the 2006 projection to the average pattern for the projections of the most recent three years.

The estimate was allocated between General Fund and Navy Working Capital Fund using a percentage based on the number of civilian employees taken from the Navy Budget Tracking System. The following table details the numbers used in support of the allocation:

	Personnel	Allocation %
DON General Fund	84,068	44%
Navy Working Capital Fund	108,166	56%
Total	192,234	100%

Note 18. General Disclosures Related to the Statement of Net Cost

Intragovernmental Costs and Exchange Revenue		
As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Intragovernmental Costs	\$ 40,177,296	\$ 39,245,020
2. Public Costs	89,352,957	84,365,787
3. Total Costs	<u>\$ 129,530,253</u>	<u>\$ 123,610,807</u>
4. Intragovernmental Earned Revenue	\$ (2,551,473)	\$ (3,480,214)
5. Public Earned Revenue	(1,360,814)	(4,700,934)
6. Total Earned Revenue	<u>\$ (3,912,287)</u>	<u>\$ (8,181,148)</u>
7. Net Cost of Operations	<u>\$ 125,617,966</u>	<u>\$ 115,429,659</u>

Net Costs of Operations

The DON reported an increase in the Net Cost of Operations of \$10.2 billion, 9% in FY 2006. The pertinent changes are described below in the disclosure for Total Costs and Earned Revenue.

Total Costs

Total Costs increased \$5.9 billion, 5% in FY 2006. Public Costs increased \$5.0 billion, 6%, which represents the majority of the increase in Total Costs, while Intragovernmental Costs increased \$932.3 million.

Total Earned Revenue

Total Earned Revenue decreased \$4.3 billion, 52%. The majority of the total decrease is in Public Earned Revenue which decreased \$3.3 billion, 71%, in FY 2006. The two major drivers behind the decrease in

Public Earned Revenue were:

- Marine Corps real property additions decreased \$462.0 million due to completion of construction projects and increased additions during FY 2005 that were not reflected in FY 2006.
- Navy Military construction real property asset capitalization decreased \$2.0 billion due to completion of construction projects and increased additions during FY 2005 that were not reflected in FY 2006. FY 2005 increases in acquisition value of General PP&E were recorded in Other Gains (USSGL 7190), which had a positive impact on public revenues. In FY 2006 General PP&E did not increase to the same level as during FY 2005, hence the decrease in revenue between years.
- Work performed for nonfederal customers decreased \$825.0 million from FY 2005.

Other Disclosures Related to the Statement of Net Cost

The DON recorded a prior period adjustment due to a change in the methodology for reporting of military equipment. The FY 2005 restatement impacts the value of general property, plant, and equipment and associated accumulated depreciation reported on the balance sheet. The DON has determined that developing the prior year value for the depreciation expense is cost-prohibitive, and thus has elected not to restate the Statement of Net Cost.

Intragovernmental costs and revenues are related to transactions made between two reporting entities within the Federal Government.

Public costs and revenues are exchange transactions made between DON and a nonfederal entity.

The Statement of Net Cost is unique because its principles are driven by an understanding the net cost of programs and/or organizations that the Federal Government supports through appropriations or other means. This statement provides gross and net cost information that can be related to the amount of output or outcome for a given program and/or organization administered by a responsible reporting entity.

The DON's financial management systems are unable to meet all of the requirements for full accrual accounting. Many of DON's financial and nonfinancial feeder systems and processes were designed and implemented prior to the issuance of Generally Accepted Accounting Principles (GAAP) for federal agencies. These systems were not designed to collect and record financial information on the full accrual accounting basis as required by GAAP. Most of DON's legacy systems were designed to record information on a budgetary basis. Considering these systems limitations, DON is unable to compare its intragovernmental costs and revenues with the corresponding balances of its intragovernmental trading partners.

The DON has undertaken efforts to determine the actions required to bring its financial and nonfinancial feeder systems and processes into compliance with all elements of GAAP. One such action is the revision of its accounting systems to record transactions based on the US Standard General Ledger (USSGL). Until such time as all of the DON's financial and nonfinancial feeder systems and processes are updated to collect and report financial information as required by GAAP, DON's financial data will be largely based on budgetary transactions (obligations, disbursements, and collections), transactions from nonfinancial feeder systems, and adjustments for known accruals of major items such as payroll expenses, accounts payable, and environmental liabilities.

Heritage Asset Disclosure

The DON's accounting systems do not capture information relative to Heritage Assets separately and distinctly from normal operations. The DON has not had any transfers of heritage assets or any donations of heritage assets.

Note 19. Disclosures Related to the Statement of Changes in Net Position

As of September 30	2006		2005 Restated	
	Cumulative Results of Operations	Unexpended Appropriations	Cumulative Results of Operations	Unexpended Appropriations
<i>(Amounts in thousands)</i>				
1. Prior Period Adjustments Increases (Decreases) to Net Position Beginning Balance				
A. Changes in Accounting Standards	\$ 0	\$ 0	\$ 0	\$ 0
B. Errors and Omissions in Prior Year Accounting Reports	23,218,292	0	23,218,292	0
C. Total Prior Period Adjustments	\$ 23,218,292	\$ 0	\$ 23,218,292	\$ 0
2. Imputed Financing				0
A. Civilian CSRS/FERS Retirement	\$ 219,410	\$ 0	\$ 232,513	\$ 0
B. Civilian Health	327,916	0	319,112	0
C. Civilian Life Insurance	1,066	0	1,038	0
D. Judgment Fund	29,666	0	33,023	0
E. IntraEntity	0	0	0	0
F. Total Imputed Financing	\$ 578,058	\$ 0	\$ 585,686	\$ 0

Disclosures

The Department of the Navy (DON) recorded a \$23.2 billion prior period adjustment due to a change in the methodology for reporting of military equipment, resulting in a \$23.2 billion restatement for FY 2005. The FY 2005 restatement impacts the value of general property, plant, and equipment and associated accumulated depreciation reported on the balance sheet. The DON has determined that developing the prior year value for the depreciation expense is cost-prohibitive, and thus has elected not to restate the Statement of Net Cost.

In accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 23, *Eliminating the Category National Defense Property, Plant, and Equipment*, the DON reported military equipment values in the financial statements beginning in FY 2003. As an interim measure, while DON worked to develop its military equipment baseline from internal records, the military equipment values reported were based on information obtained from the Bureau of Economic Analysis (BEA).

Effective 3rd Quarter, FY 2006, DON replaced the BEA estimation methodology with a valuation based on internal DON records. During the process of establishing a baseline, it was discovered that the BEA estimates had failed to consider disposals, thresholds, and construction in process. While an estimation methodology is acceptable per SFFAS No. 23, due to the nature of the BEA omissions, DON considers the method previously used noncompliant with Generally Accepted Accounting Principles (GAAP), and thus have treated the adjustment as correction of a material error.

Appropriations Received on the Statement of Changes in Net Position (SOCNP) does not agree with Appropriations Received on the Statement of Budgetary Resources due to differences between proprietary and budgetary accounting concepts and reporting requirements. The difference of \$19.4

million between the SOCNP Appropriations Received and the Statement of Budgetary Resources Appropriations Received is primarily due to the values for Trust Funds and Special Receipt Accounts in Appropriated Trust or Special Fund Receipts (USSGL 4114) not being included in the Appropriations Received line of SOCNP.

Imputed Financing.

The amounts the Department of Defense (DoD) remits to the Office of Personnel Management (OPM) by and for employees covered by the Civil Service Retirement System (CSRS), the Federal Employees' Retirement System (FERS), the Federal Employees' Health Benefits (FEHB) program, and the Federal Employees' Group Life Insurance (FEGLI) program do not fully cover the government's cost to provide these benefits. An imputed cost is recognized as the difference between the government's cost of providing these benefits to employees and DON contributions for them. The OPM provides the cost factors to the Defense Finance and Accounting Service (DFAS) for the computation of imputed financing costs. These costs are provided by DFAS to the Office of the Under Secretary of Defense (Personnel and Readiness) for validation and approval. The approved imputed costs are provided to the DoD reporting entities for inclusion in their financial statements.

Judgment Fund.

Treasury provided information related to amounts paid for Judgment Fund liabilities under the Contracts Dispute Act and the Notification of Federal Antidiscrimination and Retaliatory Act (No FEAR Act) on behalf of DON, which DON is required to repay. Judgment Fund payments made out of the following Treasury appropriations do not require reimbursement and therefore represent imputed financing to DON: 20X1740 and 20X1742. Only those payments made from Treasury appropriation 20X1743 and that portion of 20X1741 that is related to the No FEAR Act are required to be repaid by DON.

Note 20. Disclosures Related to the Statement of Budgetary Resources

As of September 30	2006	2005
<i>(Amounts in thousands)</i>		
1. Net Amount of Budgetary Resources Obligated for Undelivered Orders at the End of the Period	\$ 83,047,974	\$ 76,392,061
2. Available Borrowing and Contract Authority at the End of the Period	0	0

3. Other Information Related to the Statement of Budgetary Resources (SBR)

Apportionment Categories for Obligations Incurred

On the Statement of Budgetary Resources: Obligations Incurred includes \$146.0 billion of Direct Program Obligations and \$5.9 billion of Reimbursable Program Obligations.

On the Report on Budget Execution (SF-133):

- Direct Obligations, Category A, amounts apportioned quarterly, are \$85.1 billion.
- Direct Obligations, Category B, amounts apportioned on a basis other than quarterly, are \$60.9 billion.

- Total Direct Obligations are therefore \$146.0 billion.
- Category B Reimbursable Obligations are \$5.9 billion.

Intraentity Transactions

Intraentity transactions have not been eliminated because the statements are presented as combined and combining.

Permanent, Indefinite Appropriations.

DON has two permanent, indefinite appropriations.

National Defense Sealift Fund.

The National Defense Sealift Fund (NDSF) is operated under the authority of 10 U.S. Code 2218, which provides for the construction (including design of vessels), purchase, alteration, and conversion of Department of Defense (DoD) sealift vessels; operation, maintenance, and lease or charter of DoD vessels for national defense purposes; installation and maintenance of defense features for national defense purposes on privately owned and operated vessels that are constructed in the United States and documented under the laws of the United States; research and development relating to national defense sealift; and expenses for maintaining the National Defense Reserve Fleet (NDRF) including the acquisition, alteration or conversion of vessels built in U.S. shipyards for NDRF. As of September 30, 2006, one transfer for \$1.0 million from the Defense Working Capital Fund to the NDSF was recorded; no transfers from NDSF have occurred.

Environmental Restoration, Navy.

Environmental Restoration, Navy (ER, N) is a transfer account that funds environmental restoration, reduction and recycling of hazardous waste, removal of unsafe buildings and debris, and similar purposes. Funds are to remain available until transferred, and remain available for the same purpose and same time period as the appropriations to which transferred. As of September 30, 2006, \$296.4 million has been transferred to Operations and Maintenance, Navy and \$5.1 million has been transferred to Operations and Maintenance, Defense Agencies from ER, N. No transfers to ER, N have occurred.

Differences between the SBR and the Budget of the United States Government

Legitimate reasons can exist for differences between SBR and DON's programs in the Budget of the United States Government, such as expired unobligated balances being reported on SBR but not in the Budget.

Differences between the SBR and the SF-133 Report on Budget Execution

Differences exist between the SF-133 and the SBR for a number of reasons; including accruals recorded for fringe benefits, liabilities recorded for the Judgment Fund, and accruals recorded for trading partner advances and liabilities.

Other Disclosures

Unobligated budget authority is the difference between the obligated balance and the total unexpended balance. It represents that portion of the unexpended balance unencumbered by recorded obligations. Appropriations are provided on an annual, multi-year, and no-year basis. An appropriation expires on the last day of its period of availability and is no longer available for new obligations when in an expired status. Unobligated balances retain their fiscal year identity in an expired account for an additional five fiscal years. The unobligated balance remains available to make legitimate obligation adjustments, i.e., to record previously unrecorded obligations and to make upward obligation adjustments in previously underestimated obligations for five years. At the end of the fifth year the budget authority is canceled. Thereafter, the budget authority is not available for any purpose.

Information about legal limitations and restrictions affecting the use of the unobligated balance of budget

authority is specifically stated by program and fiscal year in the applicable appropriation language or in the alternative provisions section at the end of the appropriations act.

As noted above, the NDSF, a revolving fund, received a transfer of \$1.0 million in September 2006 from the Defense Working Capital Fund per Public Law 109-148. A transfer of resources to a revolving fund is considered a capital infusion.

Note 21. Disclosures Related to the Statement of Financing

Fluctuations and Abnormalities

Budgetary data is not in agreement with proprietary expenses and assets capitalized. This causes a difference in net cost between the Statement of Net Cost and the Statement of Financing. Adjustments are posted to the Statement of Financing for these differences. For FY 2006, an adjustment of \$9.6 million was made to Resources that Finance the Acquisition of Assets of the Statement of Financing so that proprietary accounts reconcile with the budgetary accounts. The alignment was made per Office of the Under Secretary of Defense (Comptroller) guidance.

Other Disclosures

The increase in resources that finance the acquisition of assets is primarily due to the implementation of SFFAS No. 23 "Eliminating the Category of National Defense Property, Plant, and Equipment." Correspondingly, there is also an increase in the reported depreciation for the military equipment.

The Statement of Financing is presented as a consolidated statement. However, the following Statement of Financing lines are presented as combined instead of consolidated due to interagency budgetary transactions not being eliminated:

- Obligations Incurred
- Less: Spending Authority from Offsetting Collections and Recoveries
- Obligations Net of Offsetting Collections and Recoveries
- Less: Offsetting Receipts
- Net Obligations
- Undelivered Orders
- Unfilled Customer Orders

Adjustments in funds that are temporarily not available pursuant to Public Law, and those that are permanently not available (included in the "Adjustments" line on the Statement of Budgetary Resources), are not included in "Spending Authority From Offsetting Collections and Adjustments" line on the Statement of Budgetary Resources or on the Statement of Financing. The Statement of Financing was expanded to further articulate and detail the relationship between new obligations from budgetary accounting and net cost of operations from proprietary accounting.

Description of the Other lines.

Resources Used to Finance Items not Part of the Net Cost of Operations –

The Other resources or adjustments to net obligated resources that do not affect the net cost of operations balance of \$187.1 million consists primarily of a transfer of Construction in Progress from other Defense Agencies in the amount of \$96.7 million and a transfer of property from Marine Corps Working Capital Fund to Marine Corps General Fund in the amount of \$91.5 million.

Components Requiring or Generating Resources –

The Other is related to future periods and the balance of \$208.4 million consists primarily of unfunded liabilities for employment related programs.

Components not Requiring or Generating Resources –

The Other not requiring or generating resources has a balance of \$9.7 million, which consists primarily of bad debt expense related to the allowance for doubtful accounts.

The amount reflected on the Statement of Financing of \$482.1 million reports changes in accruals of unfunded liabilities, which included but are not limited to: unused annual leave, environmental and non-environmental disposal, litigation, Federal Employees' Compensation Act (FECA), unemployment compensation, canceled year accounts payable, and contract incentives. The total of \$25.8 billion in Liabilities Not Covered by Budgetary Resources included on the Balance Sheet includes the aforementioned items and liabilities to Treasury for nonentity accounts receivable of the DON. Collections on nonentity receivables would not require or generate resources for the DON as they are deposited at Treasury and belong to the general cash balances of the United States Government.

Reconciling Item for Allocation Transfers.

There is \$34.4 million of Parent/child Allocation accounts, primarily Treasury symbol 1081, International Military Education and Training with a balance of \$34.0 million. The DON, as the "child," is the recipient of allocation transfers from other Federal agencies and has determined that the allocations are not material to the DON Financial Statements. The providing agency, as the "parent," is responsible for reporting for these allocations.

Note 22. Disclosures Related to the Statement of Custodial Activity

Not applicable.

Note 23. Earmarked Funds

BALANCE SHEET As of September 30 (Amounts in thousands)		MRF	MERHCF	Other Earmarked Funds	Eliminations	Total
ASSETS						
Fund balance with Treasury	\$	0	\$	0	\$	12,218
Investments		0		0		9,751
Accounts and Interest Receivable		0		0		0
Other Assets		0		0		22
Total Assets	\$	0	\$	0	\$	21,991
LIABILITIES and NET POSITION As of September 30						
Military Retirement Benefits and Other Employment Related						
Actuarial Liabilities	\$	0	\$	0	\$	0
Other Liabilities		0		0		1,598
Unexpended Appropriations		0		0		1,550
Cumulative Results of Operations		0		0		18,843
Total Liabilities and Net Position	\$	0	\$	0	\$	21,991
STATEMENT OF NET COST As of September 30						
Program Costs	\$	0	\$	0	\$	24,998
Less Earned Revenue		0		0		0
Net Program Costs	\$	0	\$	0	\$	24,998
Less Earned Revenues Not Attributable to Programs		0		0		0
Net Cost of Operations	\$	0	\$	0	\$	24,998
STATEMENT OF CHANGES IN NET POSITION As of September 30						
Net Position Beginning of the Period						
	\$	0	\$	0	\$	25,869
Net Cost of Operations		0		0		24,998
Other Nonexchange Revenue		0		0		19,522
Other Financing Sources		0		0		0
Change in Net Position	\$	0	\$	0	\$	(5,476)
Net Position End of Period	\$	0	\$	0	\$	20,393

Fluctuation and Abnormalities

Earmarked funds were required to be reported and disclosed separately from other funds beginning 1st Quarter, FY 2006. For DON General Fund, a reclassification to the new earmarked funds reporting attribute was performed, beginning balances were transferred from the previous attributes, and the status of the earmarked funds is displayed in this Note to the financial statements. However, prior year amounts were not remapped to the new earmarked funds reporting attributes.

General Disclosures

Earmarked funds are financed by specifically identified revenues and are required by statute to be used for designated activities or purposes. The DON has seven earmarked funds. Four are categorized as Special Funds and three are categorized as Trust Funds. A list of these earmarked funds and a brief description of each follows below. There have been no changes in legislation that significantly changes the purpose of any of the seven funds or that redirects a material portion of the accumulated balances of any of the seven funds.

Special Earmarked Funds

Wildlife Conservation, Military Reservations, Navy –

This fund, authorized by 16 United States Code 670b, provides for the development and conservation of fish and wildlife and recreational facilities on military installations. Proceeds from the sale of fishing and hunting permits are used for these programs at Navy and Marine Corps installations charging such user fees. These programs are carried out through cooperative plans agreed upon by the local representatives of the Secretary of Defense, the Secretary of the Interior, and the appropriate agency of the State in which the installation is located.

Kaho'olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy –

This fund, authorized by 107 United States Statute 1483, was established to recognize and fulfill the commitments made on behalf of the United States to the people of Hawaii and to return to the State of Hawaii the Island of Kaho'olawe. Congress has found it to be in the national interest and an essential element in the federal government's relationship with the State of Hawaii the conveyance, clearance or removal of unexploded ordnance, environmental restoration, control of access to the Island and future use of the Island be undertaken in a manner consistent with the enhancement of that relationship, the Department of Defense's military mission, the federal interest, and applicable provisions of law.

Roosmoor Liquidating Trust Settlement Account –

The Roosmoor Liquidating Trust account was established by Section 2208 of Public Law 104-106; the National Defense Authorization Act of 1996. Per the statute, monies awarded the United States when litigation is settled in favor of the Roosmoor Liquidating Trust is deposited into this account. The monies are made available to DON solely for the acquisition or construction of military family housing in, or in the vicinity of San Diego, California.

Ford Island Improvement Account –

The Ford Island Improvement fund is authorized by 10 United States Code 2814 and was established to carry out improvements to property and facilities that will deliver overall benefits to DON at the Pearl Harbor Naval Complex at Ford Island, Hawaii. Ford Island is a central feature in the Pearl Harbor National Historic Landmark. The Ford Island legislation allows DON to sell or lease properties in Hawaii and use the proceeds to develop Ford Island.

Trust Earmarked Funds

Department of the Navy General Gift Fund –

This trust fund is authorized by 10 United States Code 2601. Under the provisions of this statute, the Secretary of the Navy may accept, hold, administer, and spend any gift, devise, or bequest of real or personal property, made on the condition that they be used for the benefit, or in connection with the

establishment, operation, or maintenance of a school, hospital, library, museum, cemetery, or other institution under the jurisdiction of the Department of the Navy.

Ships Stores Profit, Navy –

This trust fund is authorized under 10 United States Code 7220. Deposits to this fund are derived from profits realized through the operation of ships' stores and from the acceptance of gifts accepted for the purpose of providing recreation, amusement, and contentment for enlisted members of the Navy and Marine Corps.

U.S. Naval Academy General Gift Fund –

This trust fund is authorized by 10 United States Code 6973. Under the provisions of this statute, the Secretary of the Navy may accept, hold, administer, and spend any gift, devise, or bequest of personal property, made on the condition that it they used for the benefit, or in connection with the United States Naval Academy, or the Naval Academy Museum, its collections, or its services.

Note 24. Other Disclosures

As of September 30	2006 Asset Category			
	Land and Buildings	Equipment	Other	Total

(Amounts in thousands)

1. ENTITY AS LESSEE-

Operating Leases

Future Payments Due

Fiscal Year

2007	\$	14,317	\$	0	\$	464	\$	14,781
2008		14,722		0		476		15,198
2009		15,230		0		487		15,717
2010		15,164		0		500		15,664
2011		15,690		0		512		16,202
After 5 Years		0		0		0		0

Total Future Lease

Payments Due	\$	75,123	\$	0	\$	2,439	\$	77,562
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Fluctuations and Abnormalities

Although a comparative column is not shown, the DON reported a decrease of \$28.4 million in Operating Leases Future Payments Due in FY 2006. This decrease is due to the ongoing effort to validate operating leases throughout the Navy shore establishment.

Lessee – A person or entity that receives the use and possession of leased property (e.g. real estate or equipment) from a lessor in exchange for a payment of funds.

Operating Lease - A lease that does not substantially transfer all the benefits and risk of ownership; payments are charged to expense over the lease term as they become payable.

Other Disclosure

The values reported for operating leases is derived from DON data collection process. This process only provides summary level values at this time. Lease periods vary and are not expected to be renewed at the end of the lease term. There are no material escalation clauses or contingent rental restrictions. Data is gathered from existing leases, General Service Administration bills, and Interservice Support Agreements. Future year projections use the Consumer Price Index (CPI), rather than the DoD inflation factor. The CPI more accurately impacts increases to the leases, especially those at commercial lease sites.

General Fund Budgeting/Combining Statements 2006



Department of Defense

Department of the Navy

CONSOLIDATING BALANCE SHEET

As of September 30, 2006 and 2005

(\$ in thousands)

	Navy	Marine Corps	Combined Total
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	\$ 84,567,726	\$ 11,373,735	\$ 95,941,461
Non-entity Seized Iraqi Cash	0	0	0
Non-entity - Other	356,131	118,376	474,507
Investments (Note 4)	9,751	0	9,751
Accounts Receivable, Net (Note 5)	138,151	37,983	176,134
Other Assets (Note 6)	462,485	5,774	468,259
Total Intragovernmental Assets	\$ 85,534,244	\$ 11,535,868	\$ 97,070,112
Cash and Other Monetary Assets (Note 7)	116,657	59,649	176,306
Accounts Receivable (Note 5)	3,209,853	21,561	3,231,414
Loans Receivable (Note 8)	0	0	0
Inventory and Related Property, Net (Note 9)	58,324,063	470,571	58,794,634
General Property, Plant and Equipment, Net (Note 10)	178,481,762	8,497,907	186,979,669
Investments (Note 4)	0	0	0
Other Assets (Note 6)	8,109,607	499,268	8,608,875
TOTAL ASSETS	\$ 333,776,186	\$ 21,084,824	\$ 354,861,010
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	\$ 945,180	\$ 106,727	\$ 1,051,907
Debt (Note 13)	0	0	0
Other Liabilities (Note 15 & Note 16)	4,197,133	263,020	4,460,153
Total Intragovernmental Liabilities	\$ 5,142,313	\$ 369,747	\$ 5,512,060
Accounts Payable (Note 12)	\$ 789,577	\$ 475,959	\$ 1,265,536
Military Retirement and Other Federal Employment-Related Actuarial Liabilities (Note 17)	1,299,211	214,433	1,513,644
Environmental and Disposal Liabilities (Note 14)	17,042,343	226,470	17,268,813
Loan Guarantee Liability (Note 8)	0	0	0
Other Liabilities (Note 15 and Note 16)	4,815,278	934,486	5,749,764
TOTAL LIABILITIES	\$ 29,088,722	\$ 2,221,095	\$ 31,309,817
NET POSITION			
Unexpended Appropriations - Earmarked Funds (Note 23)	\$ 1,550	\$ 0	\$ 1,550
Unexpended Appropriations - Other Funds	88,640,658	11,057,094	99,697,752
Cumulative Results of Operations - Earmarked Funds	18,843	0	18,843
Cumulative Results of Operations - Other Funds	216,026,413	7,806,635	223,833,048
TOTAL NET POSITION	\$ 304,687,464	\$ 18,863,729	\$ 323,551,193
TOTAL LIABILITIES AND NET POSITION	\$ 333,776,186	\$ 21,084,824	\$ 354,861,010

Department of Defense

Department of the Navy

CONSOLIDATING BALANCE SHEET

As of September 30, 2006 and 2005

(\$ in thousands)

	Eliminations	2006 Consolidated	2005 Restated
ASSETS (Note 2)			
Intragovernmental:			
Fund Balance with Treasury (Note 3)			
Entity	\$ 0	\$ 95,941,461	\$ 85,734,659
Non-entity Seized Iraqi Cash	0	0	0
Non-entity - Other	0	474,507	344,546
Investments (Note 4)	0	9,751	9,519
Accounts Receivable, Net (Note 5)	16,864	159,270	281,305
Other Assets (Note 6)	0	468,259	672,257
Total Intragovernmental Assets	\$ 16,864	\$ 97,053,248	\$ 87,042,286
Cash and Other Monetary Assets (Note 7)	0	176,306	305,440
Accounts Receivable (Note 5)	0	3,231,414	3,267,657
Loans Receivable (Note 8)	0	0	0
Inventory and Related Property, Net (Note 9)	0	58,794,634	55,584,837
General Property, Plant and Equipment, Net (Note 10)	0	186,979,669	181,547,138
Investments (Note 4)	0	0	0
Other Assets (Note 6)	0	8,608,875	6,988,791
TOTAL ASSETS	\$ 16,864	\$ 354,844,146	\$ 334,736,149
LIABILITIES (Note 11)			
Intragovernmental:			
Accounts Payable (Note 12)	\$ 16,864	\$ 1,035,043	\$ 1,208,703
Debt (Note 13)	0	0	0
Other Liabilities (Note 15 & Note 16)	0	4,460,153	3,826,048
Total Intragovernmental Liabilities	\$ 16,864	\$ 5,495,196	\$ 5,034,751
Accounts Payable (Note 12)	\$ 0	\$ 1,265,536	\$ 1,180,034
Military Retirement and Other Federal Employment-Related Actuarial Liabilities (Note 17)	0	1,513,644	1,532,819
Environmental and Disposal Liabilities (Note 14)	0	17,268,813	17,050,451
Loan Guarantee Liability (Note 8)	0	0	0
Other Liabilities (Note 15 and Note 16)	0	5,749,764	4,459,836
TOTAL LIABILITIES	\$ 16,864	\$ 31,292,953	\$ 29,257,891
NET POSITION			
Unexpended Appropriations - Earmarked Funds (Note 23)	\$ 0	\$ 1,550	\$ 0
Unexpended Appropriations - Other Funds	0	99,697,752	89,739,876
Cumulative Results of Operations - Earmarked Funds	0	18,843	0
Cumulative Results of Operations - Other Funds	0	223,833,048	215,738,382
TOTAL NET POSITION	\$ 0	\$ 323,551,193	\$ 305,478,258
TOTAL LIABILITIES AND NET POSITION	\$ 16,864	\$ 354,844,146	\$ 334,736,149

Department of Defense

Navy General Fund

CONSOLIDATING STATEMENT OF NET COST

For the Periods ended September 30, 2006 and 2005

(\$ in thousands)

	Navy	Marine Corps	Combined Total
Program Costs			
A. Military Personnel			
Gross Costs	\$ 29,263,834	\$ 10,661,165	\$ 39,924,999
(Less: Earned Revenue)	(256,353)	(20,664)	(277,017)
Net Program Costs	29,007,481	10,640,501	39,647,982
B. Operation and Maintenance			
Gross Costs	\$ 39,871,491	\$ 7,158,553	\$ 47,030,044
(Less: Earned Revenue)	(3,832,715)	(471,263)	(4,303,978)
Net Program Costs	36,038,776	6,687,290	42,726,066
C. Procurement			
Gross Costs	\$ 22,209,626	\$ 2,032,386	\$ 24,242,012
(Less: Earned Revenue)	(1,283,614)	(142,289)	(1,425,903)
Net Program Costs	20,926,012	1,890,097	22,816,109
D. Research, Development, Test & Evaluation			
Gross Costs	\$ 18,109,762		\$ 18,109,762
(Less: Earned Revenue)	(275,798)		(275,798)
Net Program Costs	17,833,964		17,833,964
E. Military Construction/Family Housing			
Gross Costs	\$ 3,401,265		\$ 3,401,265
(Less: Earned Revenue)	(621,156)		(621,156)
Net Program Costs	2,780,109		2,780,109
F. Other			
Gross Costs	\$ (2,644,581)	\$ (130,233)	\$ (2,774,814)
(Less: Earned Revenue)	2,366,799	221,751	2,588,550
Net Program Costs	(277,782)	91,518	(186,264)
G. Total Program Costs			
Gross Costs	\$ 110,211,397	\$ 19,721,871	\$ 129,933,268
(Less: Earned Revenue)	(3,902,837)	(412,465)	(4,315,302)
Net Program Costs	106,308,560	19,309,406	125,617,966
Cost Not Assigned to Programs	0	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0	0
Net Cost of Operations	<u>\$ 106,308,560</u>	<u>\$ 19,309,406</u>	<u>\$ 125,617,966</u>

Department of Defense

Navy General Fund

CONSOLIDATING STATEMENT OF NET COST

For the Periods ended September 30, 2006 and 2005

(\$ in thousands)

	Eliminations	2006 Consolidated	2005 Consolidated
Program Costs			
A. Military Personnel			
Gross Costs	\$ 0	\$ 39,924,999	\$ 39,845,683
(Less: Earned Revenue)	0	(277,017)	(501,540)
Net Program Costs	\$ 0	\$ 39,647,982	\$ 39,344,143
B. Operation and Maintenance			
Gross Costs	\$ 0	\$ 47,030,044	\$ 47,538,207
(Less: Earned Revenue)	0	(4,303,978)	(6,896,322)
Net Program Costs	\$ 0	\$ 42,726,066	\$ 40,641,885
C. Procurement			
Gross Costs	\$ 0	\$ 24,242,012	\$ 20,464,820
(Less: Earned Revenue)	0	(1,425,903)	(1,627,506)
Net Program Costs	\$ 0	\$ 22,816,109	\$ 18,837,314
D. Research, Development, Test & Evaluation			
Gross Costs	\$ 0	\$ 18,109,762	\$ 16,105,552
(Less: Earned Revenue)	0	(275,798)	(382,732)
Net Program Costs	\$ 0	\$ 17,833,964	\$ 15,722,820
E. Military Construction/Family Housing			
Gross Costs	\$ 0	\$ 3,401,265	\$ 3,957,738
(Less: Earned Revenue)	0	(621,156)	(2,686,605)
Net Program Costs	\$ 0	\$ 2,780,109	\$ 1,271,133
F. Other			
Gross Costs	\$ 403,015	\$ (3,177,829)	\$ (4,301,193)
(Less: Earned Revenue)	(403,015)	2,991,565	3,913,557
Net Program Costs	\$ 0	\$ (186,264)	\$ (387,636)
G. Total Program Costs			
Gross Costs	\$ 403,015	\$ 129,530,253	\$ 123,610,807
(Less: Earned Revenue)	(403,015)	(3,912,287)	(8,181,148)
Net Program Costs	\$ 0	\$ 125,617,966	\$ 115,429,659
Cost Not Assigned to Programs	0	0	0
(Less: Earned Revenue Not Attributable to Programs)	0	0	0
Net Cost of Operations	\$ 0	\$ 125,617,966	\$ 115,429,659

Department of Defense

Navy General Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Periods ended September 30, 2006 and 2005

(\$ in thousands)

	<u>Navy</u>	<u>Marine Corps</u>
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources		
Unobligated balance, brought forward, October 1	\$ 15,113,721	\$ 2,014,758
Recoveries of prior year unpaid obligations	3,722,816	1,539,174
Budget Authority:		
Appropriation received	121,543,102	23,968,500
Borrowing authority	0	0
Contract authority	0	0
Spending authority from offsetting collections:		
Earned		
Collected	7,190,245	577,375
Change in receivables from Federal sources	(888,223)	(60,507)
Change in unfilled customer orders		
Advances received	54,329	0
Without advance from Federal sources	567,102	(48,029)
Anticipated for the rest of year, without advances	0	0
Previously unavailable	0	0
Expenditure transfers from trust funds	0	0
Subtotal	\$ 128,466,555	\$ 24,437,339
Nonexpenditure transfers, net, anticipated and actual	774,316	(106,906)
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(3,000,805)	(252,498)
Total Budgetary Resources	\$ 145,076,603	\$ 27,631,867
Status of Budgetary Resources:		
Obligations Incurred:		
Direct	\$ 121,584,596	\$ 24,422,185
Reimbursable	5,050,915	814,800
Subtotal	\$ 126,635,511	\$ 25,236,985
Unobligated balance:		
Apportioned	\$ 17,058,081	\$ 2,139,514
Exempt from apportionment	0	0
Subtotal	17,058,081	2,139,514
Unobligated balances not available	1,383,011	255,368
Total, status of budgetary resources	\$ 145,076,603	\$ 27,631,867

Department of Defense

Navy General Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Periods ended September 30, 2006 and 2005

(\$ in thousands)

	<u>Navy</u>	<u>Marine Corps</u>
BUDGETARY FINANCING ACCOUNTS		
Budgetary Resources		
Unobligated balance, brought forward, October 1	\$ 15,113,721	\$ 2,014,758
Recoveries of prior year unpaid obligations	3,722,816	1,539,174
Budget Authority:		
Appropriation received	121,543,102	23,968,500
Borrowing authority	0	0
Contract authority	0	0
Spending authority from offsetting collections:		
Earned		
Collected	7,190,245	577,375
Change in receivables from Federal sources	(888,223)	(60,507)
Change in unfilled customer orders		
Advances received	54,329	0
Without advance from Federal sources	567,102	(48,029)
Anticipated for the rest of year, without advances	0	0
Previously unavailable	0	0
Expenditure transfers from trust funds	0	0
Subtotal	\$ 128,466,555	\$ 24,437,339
Nonexpenditure transfers, net, anticipated and actual	774,316	(106,906)
Temporarily not available pursuant to Public Law	0	0
Permanently not available	(3,000,805)	(252,498)
Total Budgetary Resources	\$ 145,076,603	\$ 27,631,867
Status of Budgetary Resources:		
Obligations Incurred:		
Direct	\$ 121,584,596	\$ 24,422,185
Reimbursable	5,050,915	814,800
Subtotal	\$ 126,635,511	\$ 25,236,985
Unobligated balance:		
Apportioned	\$ 17,058,081	\$ 2,139,514
Exempt from apportionment	0	0
Subtotal	17,058,081	2,139,514
Unobligated balances not available	1,383,011	255,368
Total, status of budgetary resources	\$ 145,076,603	\$ 27,631,867

Department of Defense

Navy General Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Periods ended September 30, 2006 and 2005

(\$ in thousands)

	<u>Navy</u>	<u>Marine Corps</u>
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Change in obligated balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	\$ 65,559,102	\$ 6,534,084
Less: Uncollected customer payments from	<u>(3,083,852)</u>	<u>(316,962)</u>
Federal sources, brought forward, October 1		
Total unpaid obligated balance	<u>62,475,250</u>	<u>6,217,122</u>
Obligations incurred, net (+/-)	\$ 126,635,511	\$ 25,236,985
Less: Gross outlays	(119,571,057)	(21,044,616)
Obligated balance transferred, net		
Actual transfers, unpaid obligations (+/-)	0	0
Actual transfers, uncollected customer	<u>0</u>	<u>0</u>
payments from Federal sources (+/-)		
Total Unpaid obligated balance transferred, net	<u>0</u>	<u>0</u>
Less: Recoveries of prior year unpaid obligations, actual	(3,722,816)	(1,539,174)
Change in uncollected customer	321,121	108,536
payments from Federal sources (+/-)		
Obligated balance, net, end of period		
Unpaid obligations	68,900,741	9,187,279
Less: Uncollected customer payments from	(2,762,731)	(208,426)
Federal sources		
Total, unpaid obligated balance, net, end of period	<u>66,138,010</u>	<u>8,978,853</u>
Net Outlays:		
Net Outlays:		
Gross Outlays	119,571,057	21,044,616
Less: Offsetting collections	(7,244,575)	(577,375)
Less: Distributed Offsetting receipts	<u>(149,284)</u>	<u>0</u>
Net Outlays	<u>\$ 112,177,198</u>	<u>\$ 20,467,241</u>

Department of Defense

Navy General Fund

COMBINING STATEMENT OF BUDGETARY RESOURCES

For the Periods ended September 30, 2006 and 2005

(\$ in thousands)

	<u>Navy</u>	<u>Marine Corps</u>
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Change in obligated balance:		
Obligated balance, net		
Unpaid obligations, brought forward, October 1	\$ 65,559,102	\$ 6,534,084
Less: Uncollected customer payments from	<u>(3,083,852)</u>	<u>(316,962)</u>
Federal sources, brought forward, October 1		
Total unpaid obligated balance	<u>62,475,250</u>	<u>6,217,122</u>
Obligations incurred, net (+/-)	\$ 126,635,511	\$ 25,236,985
Less: Gross outlays	<u>(119,571,057)</u>	<u>(21,044,616)</u>
Obligated balance transferred, net		
Actual transfers, unpaid obligations (+/-)	0	0
Actual transfers, uncollected customer	<u>0</u>	<u>0</u>
payments from Federal sources (+/-)		
Total Unpaid obligated balance transferred, net	<u>0</u>	<u>0</u>
Less: Recoveries of prior year unpaid obligations, actual	<u>(3,722,816)</u>	<u>(1,539,174)</u>
Change in uncollected customer	321,121	108,536
payments from Federal sources (+/-)		
Obligated balance, net, end of period		
Unpaid obligations	68,900,741	9,187,279
Less: Uncollected customer payments from	<u>(2,762,731)</u>	<u>(208,426)</u>
Federal sources		
Total, unpaid obligated balance, net, end of period	<u>66,138,010</u>	<u>8,978,853</u>
Net Outlays:		
Net Outlays:		
Gross Outlays	119,571,057	21,044,616
Less: Offsetting collections	<u>(7,244,575)</u>	<u>(577,375)</u>
Less: Distributed Offsetting receipts	<u>(149,284)</u>	<u>0</u>
Net Outlays	<u>\$ 112,177,198</u>	<u>\$ 20,467,241</u>

Department of Defense

Navy General Fund

CONSOLIDATING STATEMENT OF FINANCING

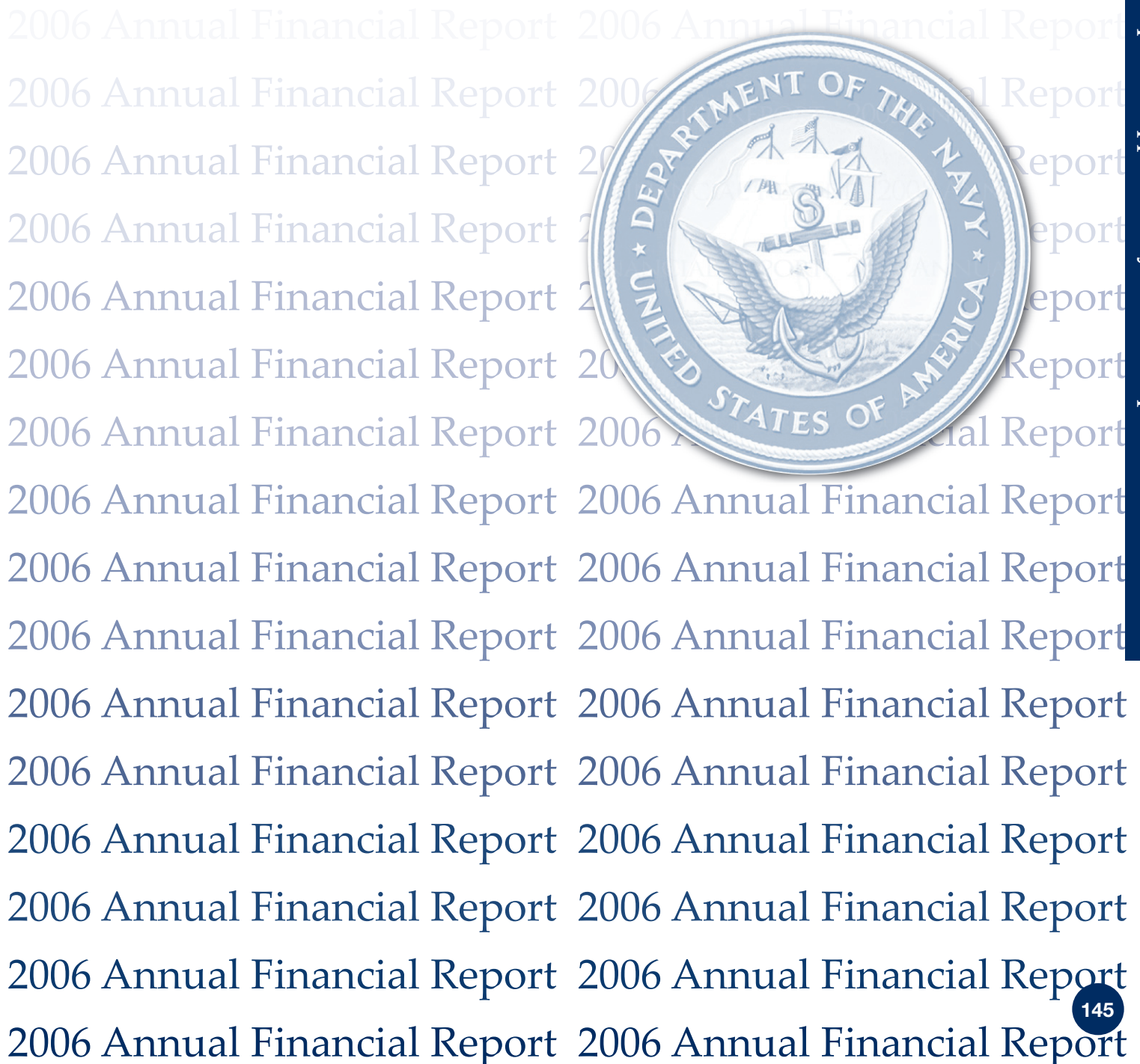
For the Periods ended September 30, 2006 and 2005

(\$ in thousands)

	Navy	Marine Corps
	<u> </u>	<u> </u>
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations Incurred	\$ 126,635,511	\$ 25,236,985
Less: Spending authority from offsetting collections and recoveries (-)	<u>(10,646,269)</u>	<u>(2,008,013)</u>
Obligations net of offsetting collections and recoveries	115,989,242	23,228,972
Less: Offsetting receipts (-)	<u>(149,284)</u>	<u>0</u>
Net obligations	115,839,958	23,228,972
Other Resources		
Donations and forfeitures of property	0	0
Transfers in/out without reimbursement (+/-)	96,689	90,379
Imputed financing from costs absorbed by others	510,817	67,241
Other (+/-)	<u>0</u>	<u>0</u>
Net other resources used to finance activities	607,506	157,620
Total resources used to finance activities	<u>\$ 116,447,464</u>	<u>\$ 23,386,592</u>
Resources Used to Finance Items not Part of the Net Cost of Operations:		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided		
Undelivered orders (-)	(3,830,416)	(2,827,292)
Unfilled Customer Orders	621,431	(48,029)
Resources that fund expenses recognized in prior periods	(101,474)	(27)
Budgetary offsetting collections and receipts that do not affect net cost of operations	149,284	0
Resources that finance the acquisition of assets	(25,488,612)	(2,875,425)
Other resources or adjustments to net obligated resources that do not affect net cost of operations		
Less: Trust or Special Fund Receipts Related to exchange in the Entity's		
Budget (-)	0	0
Other (+/-)	<u>(96,689)</u>	<u>(90,379)</u>
Total resources used to finance items not part of the net cost of operations	<u>\$ (28,746,476)</u>	<u>\$ (5,841,152)</u>
Total resources used to finance the net cost of operations	<u>\$ 87,700,988</u>	<u>\$ 17,545,440</u>
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
Increase in annual leave liability	\$ 43,363	\$ 0
Increase in environmental and disposal liability	3,908	226,470
Upward/Downward reestimates of credit subsidy expense (+/-)	0	0
Increase in exchange revenue receivable from the public (-)	0	0
Other (+/-)	<u>103,016</u>	<u>105,361</u>
Total components of Net Cost of Operations that will require or generate resources in future periods	\$ 150,287	\$ 331,831
Components not Requiring or Generating Resources:		
Depreciation and amortization	\$ 19,784,673	\$ 1,458,780
Revaluation of assets and liabilities (+/-)	1,890,592	(25,176)
Other (+/-)		
Trust Fund Exchange Revenue	0	0
Cost of Goods Sold	0	0
Operating Material & Supplies Used	(3,209,710)	(64)
Other	<u>(8,270)</u>	<u>(1,405)</u>
Total components of Net Cost of Operations that will not require or generate resources	\$ 18,457,285	\$ 1,432,135
Total components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	<u>\$ 18,607,572</u>	<u>\$ 1,763,966</u>
Net Cost of Operations	<u><u>\$ 106,308,560</u></u>	<u><u>\$ 19,309,406</u></u>

Combined Total	Eliminations	2006 Consolidated	2005 Consolidated
\$ 151,872,496	\$ 0	\$ 151,872,496	\$ 151,158,165
(12,654,282)	0	(12,654,282)	(20,485,056)
139,218,214	0	139,218,214	130,673,109
(149,284)	0	(149,284)	(115,805)
139,068,930	0	139,068,930	130,557,304
0	0	0	0
187,068	0	187,068	(1,652)
578,058	0	578,058	585,686
0	0	0	0
765,126	0	765,126	584,034
\$ 139,834,056	\$ 0	\$ 139,834,056	\$ 131,141,338
(6,657,708)	0	(6,657,708)	(13,332,332)
573,402	0	573,402	(488,685)
(101,501)	0	(101,501)	(269,715)
149,284	0	149,284	0
(28,364,037)	0	(28,364,037)	(14,697,475)
0	0	0	0
(187,068)	0	(187,068)	1,652
\$ (34,587,628)	\$ 0	\$ (34,587,628)	\$ (28,786,555)
\$ 105,246,428	\$ 0	\$ 105,246,428	\$ 102,354,783
\$ 43,363	\$ 0	\$ 43,363	\$ 170,047
230,378	0	230,378	1,028,763
0	0	0	0
0	0	0	0
208,377	0	208,377	69,091
\$ 482,118	\$ 0	\$ 482,118	\$ 1,267,901
\$ 21,243,453	\$ 0	\$ 21,243,453	\$ 15,844,303
1,865,416	0	1,865,416	(1,785,299)
0	0	0	(10)
0	0	0	0
(3,209,774)	0	(3,209,774)	(2,244,170)
(9,675)	0	(9,675)	(7,849)
\$ 19,889,420	\$ 0	\$ 19,889,420	\$ 11,806,975
\$ 20,371,538	\$ 0	\$ 20,371,538	\$ 13,074,876
\$ 125,617,966	\$ 0	\$ 125,617,966	\$ 115,429,659

General Fund Fiscal Year Stewardship Information 2006



INVESTMENTS IN RESEARCH AND DEVELOPMENT
Yearly Investment in Research and Development
For Fiscal Years 2002 through 2006
(In Millions of Dollars)

(a)	(b)	(c)	(d)	(e)	(f)
Categories	FY02	FY03	FY04	FY05	FY06
1. Basic Research	\$378	\$399	\$431	\$437	\$449
2. Applied Research	647	743	686	692	739
3. Development					
Advanced Technology Development	779	836	967	951	912
Advanced Component Development And Prototypes	2,415	2,536	2,361	3,030	3,223
System Development and Demonstration	2,836	4,200	6,115	7,094	7,819
Research, Development, Test, and Evaluation Management Support	838	797	906	955	1,022
Operational Systems Development	2,417	2,385	1,820	3,775	3,399
Total	\$10,310	\$11,896	\$13,286	\$16,934	\$17,563

Narrative Statement

Investments in Research and Development

Investment values included in this Report are based on Research and Development (R&D) outlays (expenditures). Outlays are used because current Department of Navy (DON) systems are unable to fully capture and summarize costs in accordance with FASAB standards.

A. Basic Research

Basic Research is the systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications, processes, or products in mind. Basic Research involves the gathering of fuller knowledge or understanding of the subject under study. Major outputs are scientific studies and research papers.

The following are two representative program examples for the Basic Research category.

Cosmic Battle Creates Milky-Way Sized Tunnel

The National Aeronautics and Space Administration, the Naval Research Laboratory's radio astronomy researchers, the National Radio Astronomy Observatory, and the National Science Foundation (NSF), under a cooperative agreement with Associated Universities, Inc., supported a team of astronomers who discovered a giant Milky Way-sized tunnel filled with high energy particles in a distant galaxy cluster. These new findings are of special interest to astronomers as they may provide the missing evolutionary link necessary to understand the cycle of cosmic birth and death, as well as the environmental impact of radio jets, which result from ravenous super-massive black holes within giant galaxies.

Using the Chandra X-ray Observatory to study the multi-million degree gas in the galaxy cluster, Abell 2597, the research scientists discovered an unusual X-ray tunnel large enough to fit the entire Milky Way galaxy inside. The cluster, located at a distance of roughly one billion light years from the Earth, contains a tunnel in the hot gas, which measures nearly 110 thousand light years by 36 thousand light years in size. The tunnel, which appears to originate near the core of the central giant galaxy in the cluster, may be more than 200 million years old. A constant battle is being waged in the central regions of clusters of galaxies. The hot gas invades the core of the cluster and feeds the super-massive black hole that is lurking there.

The fact that the tunnel connects back to the super-massive black hole suggests that the black hole is trying to breach the cluster's defenses in the same area where it has been successful in the past. Astronomers are far from understanding the complex interactions between radio jets and the hot gas in galaxy clusters. Further progress in the field will require sensitive observations at even longer wavelengths, but unfortunately the current suite of low frequency radio telescopes are already at their limits of sensitivity and resolution.

To address this shortcoming, astronomers at several institutions, collectively known as the Southwest Consortium, are contributing to an effort to build the world's largest and most sensitive low-frequency telescope, called the Long Wavelength Array (LWA). The LWA will operate at wavelengths between 15 and 3.75 meters (or 20 and 80 Megahertz) and has the potential to revolutionize future studies of radio galaxies and galaxy clusters. Current plans call for the LWA to be sited near the Very Large Array in New Mexico. Ironically, the LWA will operate at the same frequencies at which the first extra-terrestrial radio emissions were discovered, thus representing a return to the very roots of radio astronomy.

Bering Sea Ecosystem Responding to Changes in Arctic Climate

The Western Shelf-Basin Interactions (SBI) research project conducted a series of research cruises to observe changes in the carbon balance of the offshore areas of the Alaskan Arctic and their effects on the food chain. The cruises included a number of researchers supported by the Office of Naval Research (ONR), the NSF, and the National Oceanic and Atmospheric Administration. The group also funded researchers who contributed data collected by the Bering Strait Environmental Observatory, which annually samples waters in the northern Bering Sea to assess the biological status of productive animal communities on the sea floor.

Physical changes, including rising air and seawater temperatures and decreasing seasonal ice cover, appear to be the cause of a series of biological changes in the northern Bering Sea ecosystem that could have long range and irreversible effects on the animals that live there and on the people who depend on them for their livelihoods. In a paper published in the journal, *Science*, a team of U.S. and Canadian researchers used data from long-term observations of physical properties and biological communities to conclude that previously documented physical changes in the Arctic in recent years are profoundly affecting Arctic life. The northern Bering Sea provides critical habitat for large populations of sea ducks, gray whales, bearded seals, and walruses, all of which depend on small bottom-dwelling creatures for sustenance.

While the climatic changes researchers are observing are not uniform throughout the Bering Sea, the changes are tied to the nature of the sea ice. In the southeast Bering Sea, fish population and bottom-dwelling animal changes are taking place in the context of a complete loss of sea ice. But in the northern Bering Sea, ecological changes are occurring in the context of shifts in the quality of the sea ice. Satellite observations and other measurements, combined with observations of native Yupik hunters, confirm that sea ice extent and thickness have become greatly reduced in recent years. Also, observations by scientists on the SBI research cruises confirm that walrus mothers were leaving their pups when sea ice the animals normally use as a summer resting platform, retreated to the north. Shifts in fish populations have also been observed, including the appearance of juvenile pink salmon in rivers that drain into the Arctic Ocean, much farther north than normal.

B. Applied Research

Applied Research is the systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met. It is also the practical application of such knowledge or understanding for the purpose of meeting the recognized need. This research points toward specific military needs with a view toward developing and evaluating the feasibility and practicability of proposed solutions and determining their parameters. Major outputs of applied research are scientific studies, investigations and research papers, hardware components, software codes, and limited construction of, or part of, a weapon system to include nonsystem specific development efforts.

The following are two representative program examples for the Applied Research category.

Nanorobot Fabrication Makes Ultrasmall Sensors Possible

Researchers at the ONR are using nanotechnology to help answer the question of how to build an infrared (IR) camera that is small enough to fit on a mini-unmanned aerial vehicle (UAV) without cryogenic cooling. Nanotechnology is the understanding and control of matter at dimensions of roughly 1 to 100 nanometers and involves imaging, measuring, modeling, and manipulating matter at this length scale. As a point of reference, a nanometer is one-billionth of a meter; a single sheet of paper is about 100,000 nanometers thick.

Researchers working with the ONR developed a way to build extremely small sensors using nanorobot fabrications. ONR researchers created this new process and Michigan State University scientists implemented it. This technology allows a human operator to use a powerful microscope and a hand-held controller to manipulate nano-sized contact points remotely—similar to using extremely small hands—to construct the pixel elements that will form the heart of the sensor.

The reason for making such a small sensor has to do with the largest of things—protecting multibillion-dollar aircraft carriers and other ships and their thousands of Sailors and Marines. To improve the ability of carrier strike groups to detect enemy missiles over the horizon, the U.S. Navy is searching for ways to augment its surveillance capabilities with a covert team of mini-UAVs, also known as drones, equipped with passive sensors that can cruise near the ocean surface at slow speeds for many hours. A small UAV is possible with the advent of nano-based sensors.

Free-Electron Laser Being Developed For Shipboard Defense

The Free-Electron Laser (FEL), currently housed at the Energy Department's Thomas Jefferson National Accelerator Facility in Newport News, Virginia, is funded by the Office of Naval Research's Directed Energy Program. It is also used by the Army, Air Force, industry, and academia for research. The FEL could be ready for deployment as a shipboard defense against enemy missiles onboard ships like DD(X) next-generation destroyers and CVN-21-class carriers by 2020. The flexibility and range of the laser has been one of the main reasons these varying partners are interested in pursuing the technology.

The FEL's ability to tune to different wavelengths makes it more desirable for shipboard defense – whether to detect missiles or to destroy them – because its beam is not affected by atmospheric interference, which is thickest over the sea's surface. During FY 2006, FEL achieved 10 kilowatts of infrared laser light, 10 million times more powerful than grocery store scanners, making the laser the most powerful of its kind in the world.

The level of output of a FEL, which works best for the Navy at sea level and in a humid environment, has increased in order of magnitude every three years. Within the next five years, the output level is expected to be 100,000 watts, which is the cusp of lethality. Researchers are confident that within an additional three to five years, the FEL's output will be one megawatt (one million watts).

The weapon's precision and power make the FEL particularly desirable for Navy needs. The FEL's range of 100 meters to "multiple kilometers," and power to adjust provide capability to tackle threats from missiles to small fishing boats, make it a good candidate for asymmetric defense.

The Army's Night Vision Laboratory is interested in the laser's ability to create very long wavelengths or terahertz light, which can penetrate the ground, to aid in the detection of improvised explosive devices (IEDs) and land mines. The Air Force would like to use the technology to produce shorter wavelengths or ultraviolet light to be used in making materials for picosatellites.

C. Development

Development takes what has been discovered or learned from basic and applied research and uses it to establish technological feasibility, assessment of operability, and production capability. Development is comprised of five stages defined below:

1. Advanced Technology Development is the systematic use of the knowledge or understanding gained from research directed toward proof of technological feasibility and assessment of operational and production rather than the development of hardware for service use. It employs demonstration activities intended to prove or test a technology or method.
2. Advanced Component Development and Prototypes evaluates integrated technologies in as realistic an operating environment as possible to assess the performance or cost reduction potential of advanced technology. Programs in this phase are generally system specific. Major outputs of Advanced Component Development and Prototypes are hardware and software components or complete weapon systems ready for operational and developmental testing and field use.
3. System Development and Demonstration concludes the program or project and prepares it for production. It consists primarily of preproduction efforts, such as logistics and repair studies. Major outputs are weapons systems finalized for complete operational and development testing.
4. RDT&E Management Support is support for installations and operations for general research and development use. This category includes costs associated with test ranges, military construction maintenance support for laboratories, operation and maintenance of test aircraft and ships, and studies and analyses in support of the R&D program.
5. Operational Systems Development is concerned with development projects in support of programs or upgrades still in engineering and manufacturing development. These projects have received approval for production, for which production funds have been budgeted in subsequent fiscal years.

The following are two representative program examples for the Development category.

Plumbing the Chemistry of Iraq IEDs

The ONR is sponsoring a research project at the Massachusetts Institute of Technology (MIT), which is analyzing the molecular interaction of explosive materials. The goal of the three-year program is to study the physics and chemistry of IEDs and find techniques to detonate or short-circuit them before they cause harm.

Two objectives of this project are developing countermeasures and developing safer and more reliable materials for our own use to defend against the IEDs. MIT researchers are conducting with research partners at Washington State University and Michigan Technological University. The funding is part of a military program called the Multidisciplinary University Research Initiative, which is designed to support technology advances and academic work in subjects representing exceptional opportunities for future military applications.

Composed of leftover Iraqi Army mortars, artillery shells, TNT, and a variety of other explosives readily available in Iraq, IEDs pose perhaps the most troublesome problem for U.S. troops on the ground. The bombs, hidden along patrol and convoy routes, are relatively cheap to make, yet have become increasingly sophisticated, more powerful, and harder for the military to defend against. Increasingly skilled insurgents have disguised IEDs as rocks or tucked them inside roadside debris and dead animals.

Other research includes testing different ways that explosives can be stimulated, or triggered – such as through heat, radiation, or mechanics. The goal from this research is to use the knowledge to make IEDs on the side of the road more vulnerable to preemptive stimuli, thereby disabling the explosive devices before they cause harm to U.S. service members.

Program Underway to Develop an Electromagnetic Rail Gun

The ONR instituted a five-year program to break through a historically elusive barrier in the field of weapons technology – a tactically useful electromagnetic (EM) rail gun. The potential of electromagnetic power to shatter the speed and range limits of traditional artillery fired by exploding gas weapons has captivated naval and land warfare visionaries for nearly a century, but the promise has always outpaced a number of stubborn technical obstacles.

The Navy has established a goal of demonstrating the feasibility of a rail gun launcher with muzzle energy of 32 megajoules (MJ), or about half the power output needed for an operational weapon, by 2011. The key metric for determining the feasibility of the rail gun is whether the launcher's containment bore – the protective shroud encapsulating the gun's twin rails and movable armature – is strong enough to survive 100 shots before needing to be replaced due to metal fatigue.

If the project succeeds, ONR predicts that a demonstration of a full-scale 64 MJ launcher could occur by 2015, followed by the fielding of an operational weapon in the year 2020. The Navy's ultimate goal is to replace traditional indirect fire weapons on attack ships with EM rail guns.

NON-FEDERAL PHYSICAL PROPERTY

The Department of the Navy does not fund this type of Activity.

General Fund
Supplementary Information
2006



Department of Defense

Navy General Fund

DISAGGREGATED STATEMENT OF BUDGETARY RESOURCES

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	Other	Research, Development, Test, & Evaluation	Operation and Maintenance	Procurement
BUDGETARY FINANCING ACCOUNTS				
Budgetary Resources				
Unobligated balance, brought forward, October 1	\$ 23,638	\$ 1,623,910	\$ 771,488	\$ 13,511,782
Recoveries of prior year unpaid obligations	354	395,523	2,759,040	1,639,323
Budget Authority:				
Appropriation received	324,023	19,132,442	44,902,797	38,728,922
Borrowing authority	0	0	0	0
Contract authority	0	0	0	0
Spending authority from offsetting collections:				
Earned				
Collected	0	470,976	4,974,223	1,127,268
Change in receivable from Federal sources	0	(86,963)	(636,293)	(30,564)
Change in unfilled customer orders				
Advances received	0	(2,208)	22,671	0
Without advance from Federal sources	0	82,227	348,410	3,219
Anticipated for the rest of year, without advances	0	0	0	0
Previously unavailable	0	0	0	0
Expenditure transfers from trust funds	0	0	0	0
Subtotal	\$ 324,023	\$ 19,596,474	\$ 49,611,808	\$ 39,828,845
Nonexpenditure transfers, net, anticipated and actual	(301,520)	144,891	733,249	34,389
Temporarily not available pursuant to Public Law	0	0	0	0
Permanently not available	(3,046)	(368,881)	(996,920)	(1,337,565)
Total Budgetary Resources	\$ 43,449	\$ 21,391,917	\$ 52,878,665	\$ 53,676,774
Status of Budgetary Resources:				
Obligations Incurred:				
Direct	\$ 24,174	\$ 19,133,972	\$ 47,785,754	\$ 36,913,814
Reimbursable	0	130,542	3,885,085	931,526
Subtotal	\$ 24,174	\$ 19,264,514	\$ 51,670,839	\$ 37,845,340
Unobligated balance:				
Apportioned	\$ 19,276	\$ 1,962,250	\$ 247,077	\$ 15,490,588
Exempt from apportionment	0	0	0	0
Subtotal	19,276	1,962,250	247,077	15,490,588
Unobligated Balance not available	0	165,154	960,749	340,846
Total status of budgetary resources	\$ 43,450	\$ 21,226,764	\$ 51,917,916	\$ 53,335,928
Change in obligated balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	\$ 60,037	\$ 7,881,595	\$ 18,006,235	\$ 43,170,095
Less: Uncollected customer payments from	0	(377,933)	(1,988,640)	(133,235)
Federal sources, brought forward, October 1	60,037	7,503,662	16,017,595	43,036,860
Total unpaid obligated balance	\$ 60,037	\$ 7,503,662	\$ 16,017,595	\$ 43,036,860
Obligations incurred, net (+/-)	\$ 24,174	\$ 19,264,514	\$ 51,670,839	\$ 37,845,340
Less: Gross outlays	(24,630)	(17,892,010)	(47,807,868)	(32,496,411)
Obligated balance transferred, net				
Actual transfers, unpaid obligations (+/-)	0	0	0	0
Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0	0	0
Total Unpaid obligated balance transferred, net	0	0	0	0
Less: Recoveries of prior year unpaid obligations, actual	(354)	(395,524)	(2,759,040)	(1,639,323)
Change in uncollected customer payments from Federal sources (+/-)	0	4,736	287,884	27,345
Obligated balance, net, end of period				
Unpaid obligations	59,227	8,858,576	19,110,166	46,879,702
Less: Uncollected customer payments from Federal sources	0	(373,196)	(1,700,757)	(105,891)
Total, unpaid obligated balance, net, end of period	59,227	8,485,380	17,409,409	46,773,811
Net Outlays:				
Net Outlays:				
Gross outlays	24,630	17,892,010	47,807,868	32,496,411
Less: Offsetting collections	0	(468,768)	(4,996,895)	(1,127,268)
Less: Distributed Offsetting receipts	(12,699)	0	(136,585)	0
Net Outlays	\$ 11,931	\$ 17,423,242	\$ 42,674,388	\$ 31,369,143

2006 Annual Financial Report

Department of Defense

Navy General Fund

DISAGGREGATED STATEMENT OF BUDGETARY

For the Years Ended September 30, 2006 and 2005

(\$ in thousands)

	Military Personnel	Military Construction/Family Housing	2006 Combined	2005 Combined
BUDGETARY FINANCING ACCOUNTS				
Budgetary Resources				
Unobligated balance, brought forward, October 1	\$ 165,732	\$ 1,031,929	\$ 17,128,479	\$ 18,027,995
Recoveries of prior year unpaid obligations	441,101	26,649	5,261,990	11,446,435
Budget Authority:				
Appropriation received	40,433,914	1,989,504	145,511,602	131,002,361
Borrowing authority	0	0	0	0
Contract authority	0	0	0	0
Spending authority from offsetting collections:				
Earned				
Collected	376,531	818,622	7,767,620	8,830,639
Change in receivable from Federal sources	(99,514)	(95,395)	(948,729)	696,667
Change in unfilled customer orders				
Advances received	0	33,866	54,329	147,708
Without advance from Federal sources	5,298	79,919	519,073	(636,393)
Anticipated for the rest of year, without advances	0	0	0	0
Previously unavailable	0	0	0	0
Expenditure transfers from trust funds	0	0	0	0
Subtotal	\$ 40,716,229	\$ 2,826,516	\$ 152,903,895	\$ 140,040,982
Nonexpenditure transfers, net, anticipated and actual	190,649	(134,248)	667,410	314,674
Temporarily not available pursuant to Public Law	0	0	0	0
Permanently not available	(413,185)	(133,706)	(3,253,303)	(1,543,442)
Total Budgetary Resources	\$ 41,100,524	\$ 3,617,140	\$ 172,708,471	\$ 168,286,644
Status of Budgetary Resources:				
Obligations Incurred:				
Direct	\$ 40,530,339	\$ 1,618,729	\$ 146,006,782	\$ 137,694,376
Reimbursable	370,706	547,855	5,865,714	13,463,789
Subtotal	\$ 40,901,045	\$ 2,166,584	\$ 151,872,496	\$ 151,158,165
Unobligated balance:				
Apportioned	\$ 88,443	\$ 1,389,961	\$ 19,197,595	\$ 15,607,505
Exempt from apportionment	0	0	0	0
Subtotal	88,443	1,389,961	19,197,595	15,607,505
Unobligated Balance not available	111,036	60,594	1,638,379	1,520,974
Total status of budgetary resources	\$ 41,100,524	\$ 3,617,139	\$ 172,708,468	\$ 168,286,644
Change in obligated balance:				
Obligated balance, net				
Unpaid obligations, brought forward, October 1	\$ 746,627	\$ 2,228,597	\$ 72,093,186	\$ 67,196,765
Less: Uncollected customer payments from	(121,321)	(779,684)	(3,400,813)	(3,340,541)
Federal sources, brought forward, October 1	625,306	1,448,913	68,692,373	63,856,224
Total unpaid obligated balance	\$ 40,901,045	\$ 2,166,583	\$ 151,872,495	\$ 151,158,165
Obligations incurred, net (+/-)	(40,296,475)	(2,098,279)	(140,615,673)	(134,815,308)
Obligated balance transferred, net				
Actual transfers, unpaid obligations (+/-)	0	0	0	0
Actual transfers, uncollected customer payments from Federal sources (+/-)	0	0	0	0
Total Unpaid obligated balance transferred, net	0	0	0	0
Less: Recoveries of prior year unpaid obligations, actual	(441,101)	(26,649)	(5,261,991)	(11,446,435)
Change in uncollected customer payments from Federal sources (+/-)	94,216	15,476	429,657	(60,273)
Obligated balance, net, end of period	910,097	2,270,253	78,088,021	72,093,186
Less: Uncollected customer payments from Federal sources	(27,105)	(764,208)	(2,971,157)	(3,400,814)
Total, unpaid obligated balance, net, end of period	882,992	1,506,045	75,116,864	68,692,372
Net Outlays:				
Net Outlays:				
Gross outlays	40,296,476	2,098,279	140,615,674	134,815,308
Less: Offsetting collections	(376,531)	(852,488)	(7,821,950)	(8,978,348)
Less: Distributed Offsetting receipts	0	0	(149,284)	(115,805)
Net Outlays	\$ 39,919,945	\$ 1,245,791	\$ 132,644,440	\$ 125,721,155

**Department of the Navy (DON) General Property, Plant, and Equipment
Real Property Deferred Annual Sustainment and Restoration Tables**

As of September 30, 2006

(\$ in Millions)

Annual Sustainment FY 2006				
	Required	Actual	Difference	
Navy	1,399	1,289	110	
Marine Corps	561	524	37	
Building, Structures, and Utilities	1,960	1,813	147	

Annual Deferred Sustainment Trend				
	FY 2003	FY 2004	FY 2005	FY 2006
Navy	-	488	248	110
Marine Corps	-	24	30	37
Building, Structures, and Utilities	-	512	278	147

Restoration and Modernization Requirements				
	End FY 2005	End FY 2006	Change	
Navy	-	2,021	2,021	
Marine Corps	-	256	256	
Building, Structures, and Utilities	-	2,277	2,277	

Narrative Statement:

Fiscal Year 2006 represents the fifth year the Facility Sustainment Model (FSM) was utilized for the Department of the Navy (DON) General Fund. Sustainment is defined as the maintenance and repair activities necessary to keep a typical facility in good working order over its service life. It includes regularly scheduled adjustments and inspections (such as for fire sprinkler heads and HVAC systems), regulatory inspections (for example, of elevators and bridges), emergency and routine preventive maintenance tasks, and major repair or replacement of facility components, such as roof replacement, refinishing wall surfaces, repairing and replacing electrical, heating, and cooling systems, and replacing tile and carpeting. In FY 2006, FSM Version 7.2 was used for programming and budgeting for facilities sustainment. Deferred amounts were calculated in accordance with the methodology provided by Department of Defense Financial Management Regulation, Volume 6B, Chapter 12.

Restoration and Modernization is currently not modeled. Restoration includes repair and replacement work to restore facilities damaged by inadequate sustainment, excessive age, disaster, accident, or other causes. Modernization includes alteration of facilities solely to implement new or higher standards and regulatory changes, to accommodate new functions including base realignment and closure (BRAC), or to renew building components that typically last more than 50 years, such as foundations and structural members. Requirements listed on the table are actual expenditures for restoration and modernization by year. The program growth evident in the funding trend reflects the impact of Hurricanes Ivan and Katrina and BRAC.

The DON General Fund has no material amounts of deferred sustainment for the General Property, Plant, and Equipment categories of Personal Property, Heritage Assets, or Stewardship Land.

Military Equipment
Deferred Maintenance Amounts
 As of September 30, 2006
 (\$ in Thousands)

Major Type	Amount
1. Aircraft	\$70,000
2. Ships	26,000
3. Missiles	78,000
4. Combat Vehicles	83,000
5. Other Weapons Systems	240,000
6. Total	<u>\$497,000</u>

Narrative Statement:

Aircraft Deferred Maintenance

Four sub-categories comprise aircraft deferred maintenance: airframe rework and maintenance (active and reserve), engine rework and maintenance (active and reserve), component repair, and software maintenance. The airframe rework deferred maintenance calculation reflects unfunded requirements, which represent aircrafts that failed Aircraft Service Period Adjustment (ASPA) inspections or reached fixed Period End Date (PED) at year-end. The engine rework deferred maintenance calculation reflects year-end actual requirements minus actual funded units. Component repair deferred maintenance represents the difference between the validated requirements minus corresponding funding.

Airframe rework and maintenance (active and reserve) is currently performed under both the Standard Depot Level Maintenance (SDLM) and Integrated Maintenance Concept (IMC) programs. Currently, the AV-8B, C-130, C-2, E-2, E-6, EA-6B, F-5, F/A-18, H-1, H-46, H-53, H-60, P-3, and S-3 aircraft programs have been incorporated under the IMC concept. The IMC concept uses Planned Maintenance Intervals (PMI), performing more frequent depot maintenance, but with smaller work packages, thereby reducing out-of-service time. The goal of this program is to improve readiness while reducing operating and support costs. The Naval Air Systems Command's (NAVAIR) Industrial Strategy is to maintain the minimum level of organic capacity, consistent with force levels, which are necessary to sustain peacetime readiness and maintain fighting surge capability. NAVAIR works in partnership with private industry to make maximum use of industry's production capabilities and for non-core related aviation depot maintenance.

Ship Deferred Maintenance

Fleet Type Commanders provide deferred ship maintenance data. Data is collected from the Current Ships Maintenance Plan (CSMP) database, which captures maintenance actions at all levels (organizational, intermediate, depot) for active and reserve ships. Only depot level deferred maintenance is provided in the calculation of ship deferred maintenance. This includes maintenance actions deferred from actual depot maintenance work-packages as well as maintenance deferred before inclusion in a work package due to fiscal, operational, or capacity constraints. Although there are some deferred maintenance actions, no ships fall into the category of, "unacceptable operating condition." Any ship that would be at risk of being in unacceptable operating condition would receive priority for maintenance funding to maintain acceptable operating condition.

Missile Maintenance

Four categories are used to determine missile maintenance: missiles, tactical missiles, software maintenance, and other. Deferred maintenance is defined as the difference between the total weapon maintenance requirement as determined by requirements modeling processes and the weapon maintenance that is funded in accordance with the annual budget controls for the missile maintenance

program. The maintenance requirements model projects the quantity of missiles and missile components per weapon system that are required to be maintained or reworked annually.

Combat Vehicles

The combat vehicles category refers to deferred vehicle maintenance for the active and reserve Marine Corps assets. The combat vehicle category consists of weapons systems such as the M1A1 Tank, the Amphibious Assault Vehicle, the Hercules Recovery Vehicle, and the Light Armored Vehicle. The total requirement is the planned quantity of combat vehicles that require depot level maintenance in a year as determined by program managers and the operating forces with requirements validated by a modeling process. The deferred maintenance is the difference between the validated requirements and funding received for that fiscal year.

Other Weapons Systems

The Other Weapons Systems category is comprised of ordnance, end item maintenance for support equipment, camera equipment, landing aids, calibration equipment, air traffic control equipment, target systems, expeditionary airfield equipment, special weapons, target maintenance, and repair of repairable components. Three categories define ordnance maintenance: ordnance maintenance, software maintenance, and other. Although the various programs differ in the methodology in defining requirements, all programs define deferred maintenance as the difference between validated requirements and funding.

Software Maintenance

Software maintenance requirements and deferred maintenance for aircraft, missiles, and other equipment are determined using the same methodology and therefore will not be addressed separately for each Military Equipment Deferred Maintenance reporting categories. Software maintenance includes the operational and system test software that runs in the airborne avionics systems (e.g., mission computer, display computer, radar) and the software that runs the ground-based support labs used to perform software sustainment (e.g., compilers, editors, simulation, configuration management).

HERITAGE ASSETS

For Fiscal Year Ended September 2006

	Measurement Quantity	As of Oct 1, 2005	Additions	Deletions	As of Sep 30, 2006
Museums	Each	27	-	-	27
Monuments & Memorials	Each	526	26	-	552
Cemeteries	Sites	60	1	-	61
Archeological Sites	Sites	23,941	-	6,153	17,788
Buildings and Structures	Each	9,092	-	-	9,092
Major Collections	Each				

(See Supplemental Reporting, pg. 156)

Narrative Statement:

The DON is required to report Heritage Assets in accordance with the following public laws and regulations:

- Antiquities Act of 1906
- Historic Sites Act of 1935
- USC 470 National Historic Preservation Act of 1966
- National Environmental Policy Act of 1969
- American Indian Religious Freedom Act of 1978
- Archeological Resources Protection Act of 1979
- Native American Graves Protection & Repatriation Act of 1990
- Presidential Memorandum for Heads of Executive Departments and Agencies: Government to Government Relations with Native American Tribal Governments Act of 1994
- 36 CFR 79 – Curation of Federally Owned and Administered Archeological Collections
- 36 CFR 60.4 – National Register of Historic Places
- Federal Accounting Standards Advisory Board (FASAB) Standard 29, “Heritage Assets and Stewardship Land”
- Executive Order 13287 – Preserve America – of 2003
- Executive Order 13327 – Federal Real Property Asset Management – of 2004
- SECNAVINST 5755.1A – Navy Museums – of 1992

In general, the DON defines Heritage Assets as items that are unique for one or more of the following reasons: historical or natural significance; cultural, educational or artistic importance; or significant architectural characteristics. Monetary values are not required for Heritage Asset reporting; only physical units of measure are reported.

Explanation for adjustments, additions, and deletions. In FY 2006, adjustments to Archeological Sites were made after a reconciliation to the DON Federal Archeology Report was performed.

Accurate inventories of archaeological artifacts, archaeological sites, and buildings and structures are dependent on full implementation of tracking systems, notably the Internet Naval Facilities Asset Database Store (iNFADS) and the Department of the Navy Heritage Asset Management System (DONHAMS), and related use of historic property data elements for buildings and structures.

Process used to define assets as Heritage Assets. The processes used to define items as having heritage significance varies between categories and type of assets being evaluated. Subject matter experts, including historians and curators, play a significant role in the definition process in addition to other criteria such as being listed on the National Register of Historic Places. In all cases, a myriad of federal statutes, service regulations, and other guidelines mandate heritage significance or provide guidance in its determination.

Multi-Use Heritage Assets. Per DoD Financial Management Regulation (FMR) Volume 6B, “Form and Content of the Department of Defense Audited Financial Statements,” Multi-Use Heritage Assets are reported as Heritage Assets on the RSSI and on the Balance Sheet as Real Property.

Information Pertaining to the Condition of DON Heritage Assets. The methodology used to report the condition of the heritage assets was a combination of visual assessment of the objects, historic value to DON collection, and general display and storage standards for historic collections. The overall condition of the collection objects is good.

Museums

Museums are buildings, places, or institutions devoted to the acquisition, conservation, study, exhibition, and educational interpretation of objects having scientific, historical, or artistic value. Secretary of the Navy Instruction 5755.1A, Navy Museums, defines the scope of the Navy Museum program.

Monuments and Memorials

Monuments and Memorials have significant monetary and/or historical value to DON.

Cemeteries

Cemeteries are government owned burial grounds on which gravesites of prominent historical figures may be located in addition to other gravesites.

Archeological Sites

Archeological Sites are lands on which items of significance are located.

Buildings and Structures

Buildings and Structures are listed as or determined eligible for listing on the National Register of Historic Places, including Multi-Use Heritage Assets. Criteria for evaluating National Register eligibility of these sites may be referenced at 36 CFR 60.4.

Supplemental Reporting. In addition to the data presented in the table above, the following supplemental information on Major Collections was reported as of September 30, 2006:

Category	Measurement Quantity	As of Oct 1, 2005	Additions	Deletions	As of Sep 30, 2006
Archeological Artifacts	Cubic Feet	14,271	3,779	-	18,050
Archival	Linear Feet	97,289	859	-	98,148
Artwork	Item	38,478	335	11	38,802
Historical Artifacts	Item	1,145,715	2,360	340	1,145,735

Archeological Artifacts

In FY 2006 an adjustment of 3,779 cubic feet of Archeological Artifacts was made subsequent to the completion of a reconciliation with DON Federal Archeology Report.

Archival

The FY 2006 increase of 859 linear feet of Archival items is primarily due to the receipt of additional Command Chronology reports.

Artwork

The FY 2006 net increase of 324 Artwork items reflects normal acquisitions and donations.

Historical Artifacts

The net increase of 2,020 Historical Artifacts reflects normal acquisitions and donations.

STEWARDSHIP LAND
 For Fiscal Year Ended September 30, 2006
(Acres in Thousands)

(a)	(b)	(c)	(d)	(e)
Land Use	As of Oct 1, 2005	Additions	Deletions	As of Sep 30, 2006
1. Mission	2,026	0	0	2,026
2. Parks & Historic Sites	0	0	0	0
Totals	2,026	0	0	2,026

Narrative Statement

The DON followed the definition of Stewardship Land per DoD FMR to include Public Domain, Land Set Aside, and Donated Land. The iNFADS was used to derive acres for Stewardship Land. Within the definition of Stewardship Land, land can be further categorized as Improved, Semi-Improved or in the Other Category of land.

Schedule, Part A DoD Intragovernmental Asset Balances	Treasury Index:	Fund Balance with Treasury	Accounts Receivable	Loans Receivable	Investments	Other
(\$ Amounts in Thousands)						
Department of Agriculture	12		2,671			
Department of Commerce	13					2,165
Department of the Interior	14		10			80,587
Department of Justice	15		4,922			
United States Postal Service	18		13			
Department of State	19		2,853			
Department of the Treasury	20	96,415,968	355		9,751	
Army General Fund	21		16,144			73
Resolution Trust Corporation	22		1			
Office of Personnel Management	24					37,062
Nuclear Regulatory Commission	31		97			
Department of Veterans Affairs	36					
Government Printing Office	4		2			
General Service Administration	47		3			11,887
National Science Foundation	49		263			92
Air Force General Fund	57		13,973			184,167
Environmental Protection Agency	68					2,250
Department of Transportation	69		688			116,132
Homeland Security	70		20,082			
Agency for International Development	72		27			
Small Business Administration	73					107
Department of Health and Human Services	75		71			24
National Aeronautics and Space Administration	80		1,946			696
Department of Housing and Urban Development	86		20			
Department of Energy	89		371			551
Department of Education	91		356			
US Army Corps of Engineers	96		518			
Other Defense Organizations General Funds	97		36,417			25
Other Defense Organizations Working Capital Funds	97-4930		23,090			21,046
Army Working Capital Fund	97-4930.001		1,745			
Navy Working Capital Fund	97-4930.002		32,128			11,393
Air Force Working Capital Fund	97-4930.003		502			
Totals might not match the Principal Statements	Totals	\$96,415,968	\$159,268	\$0	\$9,751	\$468,257

Schedule, Part B DoD Intragovernmental Entity Liabilities	Treasury Index:	Accounts Payable	Debts/Borrowings From Other Agencies	Other
(\$ Amounts in Thousands)				
Department of Agriculture	12	906		
Department of Commerce	13	1,701		
Department of the Interior	14	5,900		
Department of Justice	15	1,408		
Department of Labor	16			628,791
Department of State	19	16,601		
Department of the Treasury	20	28,357		
Army General Fund	21	52,816		
Office of Personnel Management	24			36,505
Nuclear Regulatory Commission	31	21		
Department of Veterans Affairs	36	2,901		
General Service Administration	47	154,926		
National Science Foundation	49	1,518		
Air Force General Fund	57	44,066		
Tennessee Valley Authority	64	492		
Environmental Protection Agency	68	245		
Department of Transportation	69	32,791		
Homeland Security	70	13,876		
Small Business Administration	73	170		
Department of Health and Human Services	75	57		
National Aeronautics and Space Administration	80	6,852		
Department of Energy	89	99,131		
US Army Corps of Engineers	96	770		
Other Defense Organizations General Funds	97	13,568		1,997
Other Defense Organizations Working Capital Funds	97-4930	236,564		
Army Working Capital Fund	97-4930.001	11,884		
Navy Working Capital Fund	97-4930.002	301,721		
Air Force Working Capital Fund	97-4930.003	5,802		
The General Fund of the Treasury	99			3,792,860
Totals might not match the Principal Statements	Totals	\$1,035,044	\$0	\$4,460,153

Schedule, Part C DoD Intragovernmental Revenue and Related Costs (\$ Amounts in Thousands)	Treasury Index:	Earned Revenue
Executive Office of the President	11	114,310
Department of Agriculture	12	24,608
Department of Commerce	13	2,220
Department of the Interior	14	68
Department of Justice	15	16,958
United States Postal Service	18	2
Department of State	19	9,282
Department of the Treasury	20	771
Army General Fund	21	282,160
Resolution Trust Corporation	22	18
Office of Personnel Management	24	1
Nuclear Regulatory Commission	31	2,996
Department of Veterans Affairs	36	16
Government Printing Office	4	91
General Service Administration	47	193
National Science Foundation	49	664
Air Force General Fund	57	219,519
Consumer Product Safety Commission	61	17,901
Environmental Protection Agency	68	75
Department of Transportation	69	4,701
Homeland Security	70	112,914
Agency for International Development	72	99
American Battle Monuments	74	4,359
National Aeronautics and Space Administration	80	13,886
Department of Housing and Urban Development	86	338
Department of Energy	89	2,237
Selective Service System	90	7
Department of Education	91	752
US Army Corps of Engineers	96	46,196
Other Defense Organizations General Funds	97	581,442
Other Defense Organizations Working Capital Funds	97-4930	210,978
Army Working Capital Fund	97-4930.001	
Navy Working Capital Fund	97-4930.002	728,998
Air Force Working Capital Fund	97-4930.003	1,781
DoD Medicare-Eligible Retiree Health Care Fund		125,220
Totals might not match the Principal Statements	Totals	\$2,525,761

Schedule, Part E DoD Intragovernmental Non-exchange Revenues (\$ Amounts in Thousands)	Treasury Index:	Transfers In	Transfers Out
Air Force General Fund	57	123	
Other Defense Organizations General Funds	97	96,666	
Other Defense Organizations Working Capital Funds	97-4930	38	
Navy Working Capital Fund	97-4930.002	141,492	1,251
Totals might not match the Principal Statements	Totals	\$238,319	\$1,251



Appropriations, Funds, and Accounts Included in the Principal Statements

Entity Accounts

General Funds

17X0380	Coastal Defense Augmentation, Navy
17 0703	Family Housing, Navy and Marine Corps
17 0730	Family Housing Construction, Navy and Marine Corps
17 0735	Family Housing Operation and Maintenance, Navy and Marine Corps
17X0810	Environmental Restoration, Navy
17 1000	Medicare Eligible Retiree Health Care Fund, Military Personnel Navy
17 1001	Medicare Eligible Retiree Health Care Fund, Military Personnel Marine Corps
17 1002	Medicare Eligible Retiree Health Care Fund, Reserve Personnel Navy
17 1003	Medicare Eligible Retiree Health Care Fund, Reserve Personnel Marine Corps
17 1105	Military Personnel, Marine Corps
17 1106	Operation and Maintenance, Marine Corps
17 1107	Operation and Maintenance, Marine Corps Reserve
17 1108	Reserve Personnel, Marine Corps
17 1109	Procurement, Marine Corps
17 1205	Military Construction, Navy and Marine Corps
17 1235	Military Construction, Naval Reserve
17 1236	Payments to Kaho Olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy
17 1319	Research, Development, Test and Evaluation, Navy
17 1405	Reserve Personnel, Navy
17 1453	Military Personnel, Navy
17 1506	Aircraft Procurement, Navy
17 1507	Weapons Procurement, Navy
17 1508	Procurement of Ammunition, Navy and Marine Corps
17 1611	Shipbuilding and Conversion
17 1804	Operation and Maintenance, Navy
17 1806	Operation and Maintenance, Navy Reserve
17 1810	Other Procurement, Navy

Revolving Funds

17 4557	National Defense Sealift Fund, Navy
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Earmarked Trust Funds

17X8716	Department of the Navy General Gift Fund
17X8723	Ships Stores and Profits, Navy
17X8733	United States Naval Academy General Gift Fund

Earmarked Special Funds

17X5095	Wildlife Conservation, Military Reservations, Navy
17X5185	Kaho Olawe Island Conveyance, Remediation and Environmental Restoration Fund, Navy
17X5429	Rossmoor Liquidating Trust Settlement Account
17X5562	Ford Island Improvement Account

General Fund Non- Entity Accounts

17 1XXX	Receipt Accounts
17 3XXX	Receipt Accounts
17X6XXX	Deposit Funds

Parent-Child (Allocation) Transfer Accounts

17 47X0535	Embassy Security, Defense Relocation Program, State Department
17 11 1081	International Military Education and Training Funds, appropriated to the President
17 11X1081	International Military Education and Training Funds, appropriated to the President
17 11 1082	Foreign Military Financing Program, Funds appropriated to the President
17 12X1105B	State and Private Forestry, Forest Service
17 69X8083	Federal-Aid Highways (Liquidation of Contract Authorization), Federal Highway Administration

